Generic Financing Statements Under Revised Article 9: A Proposed Reform

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The 1998 revision of the Uniform Commercial Code brought many changes, including the loosening of requirements for financing statements that allowed secured creditors to take a security interest in all or substantially all of a debtor's assets with what has been termed supergeneric language. The case law that has developed since the revision has shown problems as creditors, debtors, and courts alike have grappled with often ambiguous language and the practical consequences that follow from these interpretations, including a debtor's inability to find subsequent financing after being subject to a supergeneric financing statement. This Note evaluates the body of case law that has developed, identifies the problems that have arisen due to allowing supergeneric financing statements, and proposes solutions to these problems through the use of explicit authority for the financing statements and giving debtors greater recourse.

I. Introduction

In 1998, the American Law Institute promulgated a revision of Article 9 of the Uniform Commercial Code (U.C.C.).[1] The revision was fully adopted by all fifty states by the end of 2001.[2] Of the many changes enacted by the revisions, of particular importance is Revised Article 9's requirements for collateral descriptions in financing statements for purposes of perfection.

Revised Article 9 loosened the requirements for collateral descriptions in financing statements, allowing a financing statement to merely indicate coverage of "all assets or all personal property" of the debtor to perfect a creditor's interest in the collateral.[3] Additionally, the revisions removed the requirement of the debtor's signature on the financing statement in order to

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1. REV. U.C.C. § 9-101 cmt. 2 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999). As used in this Essay, "Revised Article 9" and "the Revised Article" refer to the Official Text of the Uniform Commercial Code published in 1999. References to "Former Article 9" or "the Former Article" refer to the 1995 Official Text. Unless otherwise indicated, the sections cited from the Revised Article 9 are the same as in the Current Article 9 (2017–2018 Edition).

2. Cynthia Grant, *Description of the Collateral Under Revised Article 9*, 4 DEPAUL BUS. & COM. L.J. 235, 235 (2006).

3. REV. U.C.C. § 9-504(2) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

facilitate electronic filing.[4] While Former Article 9 discussed the financing statement policy of "notice filing" to require subsequent inquiry into the status of the debtor's collateral,[5] Revised Article 9 realized this goal by permitting the so-called "supergeneric" language of "all assets."[6]

In the years that have followed, both subsequent creditors and Trustees in Bankruptcy have tried to fight against generic financing statements, arguing they did not provide enough notice of a prior secured creditor's interest.[7] Due to the combination of the changing of the signature requirements and the collateral descriptions, this current system of financing statements has led to a great deal of confusion and inefficiency.

This Note argues that the current state of the world where generic or supergeneric financing statements can be filed without the debtor's approval has three major problems: (1) The use of generic language creates ambiguity in situations where creditors use generic descriptions in combination with specific language identifying their collateral interest; (2) generic financing statements have a chilling effect on debtors' ability to borrow because creditors have no mandatory obligation to terminate their financing statements and Revised Article 9 provides insufficient recourse; and (3) the search costs inherent in Revised Article 9's notice-inquiry system create inefficiencies by forcing subsequent creditors to engage in redundant information research. Recognizing, however, the advantages of the notice system and the policy rationales behind it, this Note makes proposals for refining the financing statement system without a complete overhaul.

II. Revised Article 9's Changes

The two major changes Revised Article 9 made to the filing system were eliminating the requirement for the debtor to sign the financing statement and the broadening of the financing statement's collateral description.[8] Despite the allowance of generic collateral descriptions in the financing statement, the description of collateral required for the security agreement for purposes

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4. REV. U.C.C. § 9-101 cmt. 4(h) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

5. FORMER U.C.C. § 9-402 cmt. 2 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 1995).

6. REV. U.C.C. §§ 9-504 cmt. 2, 9-101 cmt. 4(h) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 1999).

7. *E.g.*, ProGrowth Bank, Inc. v. Wells Fargo Bank, N.A., 558 F.3d 809, 811–13 (8th Cir. 2009); *In re* Sterling United, Inc., 519 B.R. 586, 588 (Bankr. W.D.N.Y. 2014); *In re* GEM Refrigerator Co., 512 B.R. 194, 206–07 (Bankr. E.D. Pa. 2014); *In re* Lynch, 313 B.R. 798, 799 (Bankr. W.D. Wis. 2004); *In re* Grabowski, 277 B.R. 388, 389 (Bankr. S.D. Ill. 2002); Cmty. Trust Bank v. First Nat'l Bank, 924 So. 2d 498, 502–03 (La. Ct. App. 2006).

8. REV. U.C.C. § 9-101 cmt. 4(h) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999); Lissa Lamkin Broome, *Supergeneric Collateral Descriptions in Financing Statements and Notice Filing*, 46 GONZAGA L. REV. 435, 437–38 (2011).

of attachment still requires some specificity.[9] The difference in description requirements for the two documents stems from the U.C.C.'s policy priorities: The security agreement must identify the collateral described so the parties understand the agreement they enter into,[10] while the financing statement only needs to indicate the possibility of the collateral being encumbered and assigns the responsibility of "further inquiry" to third parties to identify the specific collateral.[11]

While the financing statement is permitted to use more generic language than the security agreement, a broader description in the financing statement cannot expand the coverage of the security agreement.[12] However, a financing statement with a more narrow description than a security agreement acts as an exclusionary document, where collateral that was not described in the financing statement is unperfected.[13] Because of the asymmetry of the treatment of generic versus detailed description, creditors are incentivized to use "supergeneric" language of "all assets" in order to get a "stranglehold" on the debtor's assets rather than risk the possibility of being underperfected by using a specific collateral description.[14] Even though a looser description

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9. REV. U.C.C. § 9-203(b)(3)(A) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999) (providing the debtor must authenticate "a security agreement that provides a description of the collateral"); REV. U.C.C. § 9-108 cmt. 2 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999) (stating that the purpose of requiring a description of collateral in the security agreement is "evidentiary"). Courts applying this section have carefully distinguished the requirements for the security agreement with those for the financing statement. *See* Vehicle Dev. Corp. v. Livernois Vehicle Dev., LLC, 995 F. Supp. 2d 758, 764–66 (E.D. Mich. 2014) (finding a security agreement that did not describe collateral but instead listed collateral categories such as "all Inventory" and "all Equipment and Fixtures" was insufficient to give the creditor an interest in the debtor's trucks); *In re* Franklin Indus. Complex, Inc., 377 B.R. 32, 47 (Bankr. N.D.N.Y. 2007) (holding the description of "all property" in a financing statement was insufficient to grant the creditor an interest in the collateral).

10. REV. U.C.C. § 9-108 cmt. 2 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

11. REV. U.C.C. § 9-502 cmt. 2 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999); *see also* First Bancorp, Inc. v. United States, 945 F. Supp. 2d 802, 812 (W.D. Ky. 2013) (stating a financing statement's collateral description requires only enough specificity to put inquirers on notice that further inquiry may be needed); *In re* The Holladay House, Inc., 387 B.R. 689, 695 (Bankr. E.D. Va. 2008) (stating the financing statement satisfies its requirement of giving notice "fairly easily").

12. Allete, Inc. v. GEC Eng'g, Inc., 726 N.W.2d 520, 523–24 (Minn. Ct. App. 2007); Sanders v. Comerica Bank, Inc., 274 S.W.3d 861, 864 (Tex. App. 2008). This rule was the same under Former Article 9. Nw. Acceptance Corp. v. Lynwood Equip., Inc., 841 F.2d 918, 922 (9th Cir. 1988).

13. *The Holladay House*, 387 B.R. at 695 ("A financing statement, more limited in scope than the security agreement which it perfects, limits the collateral in which the creditor has a perfected interest to that described in the financing statement . . . ."); *see also In re* Hintze, 525 B.R. 780, 785–86 (Bankr. N.D. Fla. 2015) (holding the collateral description used in the financing statement that was broader than the generic description used in the security could not be combined together for an enforceable security agreement).

14. *See* Broome, *supra* note 8, at 441 (working through a conceptual scenario with two creditors contending priority and concluding creditors are incentivized to include supergeneric "all assets" language in the financing statement).

might not grant the creditor additional rights, a tightly described description can only harm a possible future claim.

This incentive is perhaps even encouraged by judicial interpretation of the Revised Article 9 requirements. Courts have consistently held generic and supergeneric language in financing statements such as "all assets" or all inventory, equipment, and accounts sufficient for perfecting the creditor's interests.[15] As will be discussed in subpart III(A), these generic financing statements often create ambiguity and lead to misunderstanding by subsequent creditors.

The second major change Revised Article 9 made to the filing system was eliminating the requirement of the debtor's signature on the financing statement.[16] Under the Revised Article, a "debtor authorizes the filing of an initial financing statement" by "authenticating or becoming bound as a debtor by a security agreement."[17] Even if the creditor files overbroad language that the debtor did not agree to, the debtor is typically left without recourse.[18] One policy justification for this procedure (in addition to facilitating electronic filing) is based on the exclusionary nature of the financing statement and its inability to expand a creditor's rights.[19]

However, this reliance on the assumption that the financing statement cannot expand a creditor's rights is incorrect. In particular, the ability for subsequent security agreements filed by the initial creditor to relate back to the date of the initial financing statement means a generic collateral description will virtually always be enough to cover the agreements.[20] One commentator has described this result as an outcome not contemplated by the drafters of Revised Article 9 and yet to be addressed by the amendments after 1998.[21] This outcome serves only to incentivize creditors to file supergeneric

15. *See supra* note 7 (referencing cases arising from subsequent creditors and Trustees in Bankruptcy have litigated against generic financing statements).

16. REV. U.C.C. § 9-101 cmt. 4(h) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

17. REV. U.C.C. § 9-509(b) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999). *Cf.* FORMER U.C.C. § 9-402(1) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1995) ("A financing statement is sufficient if it . . . is signed by the debtor . . . .").

18. *See* ProGrowth Bank, Inc. v. Wells Fargo Bank, N.A., No. 07-1577 (DWF/AJB), 2009 WL 2982939, at *10–11 (D. Minn. Sept. 14, 2009) (holding the overbroad financing statement was sufficient to perfect because the financing statement "'is effective only to the extent' it is actually authorized" (emphasis omitted) (citations omitted)).

19. *Id.* at *11.

20. Broome, *supra* note 8, at 453; *see also In re* Oak Rock Financial, LLC, 527 B.R. 105, 116–18 (Bankr. E.D.N.Y. 2015) (holding the initial creditor had priority despite debtor's fulfillment of the initial loan because the original financing statement was never terminated or extinguished so subsequent extensions of credit related back to the initial perfection date).

21. Broome, *supra* note 8, at 454.

financing statements, so any subsequent extensions of credit will relate back and be deemed to have been perfected at the earlier date.[22]

Overall, the two changes to the filing system make filing a financing statement specifically identifying the encumbered collateral and putting subsequent creditors on perfect notice a questionable endeavor. Logically, all creditors would file supergeneric financing statements covering "all assets" because there are no consequences in doing so. However, as a matter of policy, future amendments to Article 9 should consider the consequences of such actions and the problems that arise from the use of these generic financing statements.

III. Problems with Generic Financing Statements

While the Revised Article 9 has been applied consistently since the enacted changes, the policy of notice-filing underlying the permissive use of generic and supergeneric collateral descriptions is problematic and should be reconsidered.

First, because collateral descriptions in financing statements are written by human attorneys, they are often prone to errors and ambiguities, particularly where a collateral description mixes a supergeneric catchall with sentences identifying the exact collateral. Attorneys may also be prone to writing lengthy sentences with an assortment of independent and dependent clauses, which can cause confusion when trying to identify which phrases are modifying which objects. Second, the current Article 9 fails to give debtors adequate control over the state of filings made on their behalf. This becomes concerning when a generic financing statement is filed by a creditor who refuses to terminate the statement even after all debts are repaid. And lastly, under notice-inquiry, subsequent creditors who are considering making loans to a debtor with previously encumbered assets must accept the search costs of determining which specific assets are encumbered and take the risk that the debtor is lying or concealing his actual situation.

This Note will address each of these problems in turn and propose moderate reforms in Part IV aimed at making this system more efficient.

A. Ambiguity

Despite the language of Revised Article 9 clearly providing for the mere indication of the collateral to be sufficient for perfection, numerous cases have arisen out of confusion about these descriptions. These problems commonly arise when the creditor filing the financing statement uses generic or supergeneric language in combination with a specific description of the

22. *See id.* at 453–54 (explaining that the recent revisions enable a debtor's later authorization of a filing to relate back to the date of the earlier filing so long as the financing statement was "broad enough to encompass [the] new collateral").

collateral.[23] Subsequent creditors are then confused by the wording of these statements and whether the financing statement covers all of the debtor's assets or only the narrow subset specifically identified. Another issue that arises in this situation is when the specific description also contains a mistake, which may mislead subsequent creditors about what assets are actually encumbered.

This first problem is illustrated by the case *In re Sterling United, Inc.*,[24] which dealt with a financing statement even the bankruptcy court called "needlessly convoluted."[25] In *Sterling United*, the bank creditor had a security interest in all of the debtor's assets and filed a financing statement describing the collateral:

> All assets of the Debtor including, but not limited to, any and all equipment, fixtures, inventory, accounts . . . now owned and hereafter acquired by Debtor and located at or relating to the operation of the premises at 100 River Rock Drive, Suite 304, Buffalo, New York, together with any products and proceeds thereof including but not limited to, a certain Komori 628 P & L Ten Color Press and Heidelberg B20 Folder and Prism Print Management System.[26]

The confusion arose when the debtor moved addresses five years after the financing statement was filed, but the collateral description was not changed to the new address until a year later.[27] After the debtor became insolvent, the Trustee argued the payments made to the bank should be returned because the bank was insufficiently perfected due to the "misleading" financing statement.[28] The court agreed there could be two interpretations of the financing statement, one that covers the collateral and one that does not.[29] However, the way to resolve this confusion was for the creditor to inquire into the status of the collateral rather than to assume the collateral was not covered.[30] The filing statement was only a "*starting* point" for a subsequent creditor to start investigating the status of the asset.[31]

The Trustee argued on appeal that the linguistic ambiguity created by the phrase was most troubling because "it is likely that a body of readers . . . will interpret the collateral description one way or the other, while not

23. *E.g.*, *ProGrowth Bank*, 558 F.3d at 811; *Sterling United*, 519 B.R. at 588; Cmty. Trust Bank v. First Nat'l Bank, 924 So. 2d 498, 502 (La. Ct. App. 2006).

24. 519 B.R. 586 (Bankr. W.D.N.Y. 2014).

25. *Id.* at 588.

26. *Id.*

27. *Id.*

28. *Id.* at 588–89.

29. *Id.* at 592.

30. *Id.*

31. *Id.*

recognizing that an ambiguity even exists."[32] The Second Circuit affirmed the district court's ruling, after engaging in a great deal of linguistic-theory discussion, to hold the financing statement was not misleading,[33] but it did not address the Trustee's argument that a reader might not even realize an ambiguity exists.[34] The U.C.C. explicitly provides that a misleading financing statement is invalid,[35] and that same principle should apply to situations where it is the possibility of ambiguity that is misleading.

The argument that financing statements are only intended to provide notice, and the possibility of another interpretation should be a sign the creditor ought to inquire as to the collateral, falls apart in this context. If the creditor reads the financing statement in *Sterling United* as only applying to the assets located in the named address and does not realize the other possible interpretations, then he has not been put on notice and the financing statement should be ineffective to perfect in the debtor's inexplicitly named assets. Under the *Sterling United* holding, secured parties would have to put themselves not in the minds of what other reasonable creditors would do but into the minds of all possible creditors and explore all possible interpretations of such financing statements. This would require the secured party to engage in an exercise of active imagination.

Since any document has the potential to be argued as being ambiguous, the secured parties will always be obligated to inquire after collateral. At this point, what purpose does the financing statement serve? If the policy reason behind using financing statements is to put third parties on notice to inquire about the status of their collateral, then the use of generic language takes all purposefulness out of the procedure. Parties can just by default assume they will have the obligation to investigate the status of whatever collateral is at issue. Without providing any specificity, filing statements serve no further purpose.

B. Debtors Lack Recourse for Delayed Termination of Overbroad Filing Statements

Another problem with allowing the use of generic collateral descriptions in financing statements is the potential chilling effect on a debtor's ability to borrow, particularly because secured creditors face no consequences for failure to properly terminate a financing statement.[36] As discussed in Part II,

32. Brief of Plaintiff-Appellant on Appeal at 36, *In re* Sterling United, Inc., 674 Fed. App'x 19 (2d Cir. 2016) (No. 15-4131-bk), 2016 WL 1426179.

33. *In re Sterling United*, 674 F. App'x at 21–22.

34. *See id.* (addressing the Trustee's argument that the different address makes the financial statement seriously misleading, but not the argument that a reader may not realize an ambiguity exists).

35. REV. U.C.C. § 9-506(a) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

36. The document needed to properly terminate a financing statement is the UCC-3.

supra, subsequent extensions of credit can "relate back" under a broad financing statement to the date of the original filing.[37] Thus, if a secured party's initial financing statement is filed with a generic or supergeneric collateral description, then subsequent extensions of credit will be deemed to have been perfected on the earlier date, giving the secured party priority over subsequent lenders.

This can limit a debtor's ability to borrow even after the original debt is paid off, because subsequent diligent creditors following the notice-inquiry policy will be hesitant to accept collateral covered by a perfected financing statement. In theory the debtor has some control, as the U.C.C. allows the debtor to file a "correction statement" with the filing office if he believes a record under his name is wrongly filed or inaccurate.[38] However, this statement has virtually no legal consequences, as it does not affect the financing statement's effectiveness.[39] Revised Article 9 noted the potential of abusing the filing system, but it left the cure to other areas of law outside the filing system.[40]

The case that best illustrates the consequences of broad statements and the difficulty debtors face in recovering damages is *Kazan v. Dough Boys, Inc.*[41] In this case, Dough Boys bought two businesses from Kazan and gave him a security interest in the assets of *one* of the businesses, named Caf Europa.[42] However, the financing statement Kazan filed was overly broad and covered *all* of Dough Boys' property.[43] Dough Boys paid off its note due to Kazan within a year of the initial transaction, but Kazan did not terminate the financing statement.[44] Three years after the initial sale, Dough Boys requested Kazan amend the overbroad financing statement to cover only the assets of Caf Europa, as Dough Boys was planning on selling both businesses to a prospective buyer named Sagaya.[45] Kazan's refusal to narrow the collateral description inhibited Dough Boys from closing on the sale of the businesses.[46] In order to resolve this issue, Dough Boys reached a settlement of sorts with Kazan, promising to pay him $60,000 for the release of his

37. *See supra* notes 20–22.

38. REV. U.C.C. § 9-518(a) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 1999). The 2013–2014 version of the U.C.C. changed the "correction statement" to "information statement" but kept all other language identical. U.C.C. § 9-518(a) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 2013).

39. REV. U.C.C. § 9-518(c) (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

40. REV. U.C.C. § 9-518 cmt. 3 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

41. 201 P.3d 508 (Alaska 2009).

42. *Id.* at 510.

43. *Id.* at 510–11.

44. *Id.* at 514.

45. *Id.* at 511.

46. *Id.*

claims.[47] Only then did he release the financing statement.[48] In later litigation between the parties on a separate matter, Dough Boys argued that Kazan "held the financing statement hostage to extract" the $60,000 payment during Dough Boys' later sale.[49] The trial court agreed and awarded Dough Boys $60,000 in damages, holding Kazan did use the financing statement to leverage this settlement at Dough Boys' expense.[50] This ruling was affirmed on appeal but reversed by the Alaska Supreme Court.[51]

The Alaska Supreme Court discussed the purpose of the financing statement as a notice document that cannot enlarge a party's right to the underlying collateral.[52] The court pointed to the Alaska adoption of the U.C.C. and stated that Dough Boys had the right to request an amendment under § 9-210, and Kazan's failure to comply would allow Dough Boys to recover damages for its inability to claim a security interest under § 9-625(g).[53] Because Dough Boys had been unable to show any damages from Kazan's overbroad financing statement and the settlement agreement was enforceable, the court held the damages award to Dough Boys was reversible error.[54]

The holding that Dough Boys did not suffer damages from the overbroad financing statement should be reexamined. There were clearly increased costs from Kazan's hold on Dough Boys' assets, as Dough Boys had to negotiate with Kazan in addition to Sagaya in closing the sale.[55] Even if the court wanted to enforce the settlement agreement between the parties, it should have acknowledged that the $60,000 Kazan received was a direct consequence of his refusal to terminate the financing statement even after the note was paid off in full. The facts given in *Kazan v. Dough Boys* paint a clear picture of a debtor who was limited in future business transactions because of an overbroad financing statement. Indeed, if the *Dough Boys* plaintiffs could not recover here, then any debtor facing difficulty in obtaining credit might never be able to see recovery. The testimony from Sagaya, the buyer himself, should have been enough to show the effect the financing statement had on Dough Boys' prospective transactions.

The Alaska Supreme Court's refusal to hold for Dough Boys shows the difficulty debtors face in showing they were harmed, and their inability to

47. *Id.*
48. *Id.*
49. *Id.* at 512 (quotations omitted).
50. *Id.*
51. *Id.* at 513, 516.
52. *Id.* at 515.
53. *See id.* at 516 (explaining that Dough Boys could have requested that Kazan's overbroad financing statement be amended and citing to the relevant Alaska provision).
54. *Id.*
55. *Id.* at 511.

receive compensation for damages. This Note argues more debtors should be given more recourse to address these issues in subpart IV(B), *infra*.

C. Inefficiencies in Allocating Search Costs

The last problem this Note will discuss is the problem of search costs under a notice-inquiry filing system. Under Revised Article 9, subsequent creditors who are confronted by a generic collateral description have the duty to undertake independent investigation to determine which specific assets are encumbered. The subsequent creditors might ask the debtor for a copy of the security agreement, but they run the risk that the debtor does not reveal all of his debts. Additionally, the debtor might have gone to multiple lenders with the same collateral, and all of these lenders would undertake search costs independently—even though they are all trying to identify the same collateral.

The redundant search costs, in terms of both expenditure and time, could be better used if there were a standard system for information disclosure. In fact, the strength of the public-disclosure requirement in the securities regulation world is meant to address exactly this issue. One way that the Article 9 financing-statement system may be able to be more efficient is to look to the policy underlying securities regulation and adapt some of its mechanisms.

In the securities world, the company (or issuer) seeking to raise money from the capital markets by issuing stock is obligated to make certain disclosures about its financials, risk factors, and past performance, as required by the Securities Act of 1933.[56] Issuers who provide fraudulent or misleading information can be responsible under various sections of the Exchange Act and under SEC Rules, and may be liable for rescission damages or price damages.[57]

Although some critics argue that this mandatory process leads to firms disclosing more information than is useful,[58] the securities-disclosure system reduces inefficient social waste from investors devoting economic resources to uncover information in pursuit of trading gains.[59] The disclosure system can also draw support "not because it is important for investors to have such

56. *See generally* 17 C.F.R. § 229 (2018) (also known as SEC Regulation S-K) (detailing mandatory disclosures through filing forms).

57. Securities Act of 1933, § 11, 12(2), 15 U.S.C.A. §§ 77k, 77l(a)(2) (2012); *see also In re* Adams Golf, Inc. Sec. Litig., 381 F.3d 267, 273 (3d Cir. 2004) (acknowledging federal liability for making false or misleading statements); Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 652 (S.D.N.Y. 1968) (outlining whether defendants will be liable for false statements).

58. *E.g.*, Kevin S. Haeberle & M. Todd Henderson, *A New Market-Based Approach to Securities Law*, 85 U. CHI. L. REV. 1313, 1328 (2018); *cf.* Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 684 (2011) (outlining the hazards of mandatory disclosure generally).

59. John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722, 733–34 (1984).

information, but because it is important to stop their wasting resources trying to get it."[60] This makes sense because attempting to identify and process firm-specific information is difficult for third parties but is an inherent byproduct of running a firm.[61] The additional cost for the firm in providing the information to the public is therefore much smaller compared to the burden information-seekers must undertake. The system of mandatory disclosure thus reduces the social cost of redundancy by making relevant information public. This helps creditors price risk when they set interest rates or decide their investments.

However, while the capital-markets system of disclosure has its advantages, such a system is perhaps ill-suited for the Article 9 filing system because filing offices act in administerial rather than regulatory roles.[62] In the securities-regulation world, the SEC has the power to enforce its rules and hand down punishment for failure to disclose material information or for disclosing fraudulent information.[63] In contrast, the U.C.C. is based on the need to transact in "good faith" and generally acts as a self-regulating system.[64] Under the securities laws, private plaintiffs can bring civil causes of action, the SEC can request the DOJ bring criminal action, and the SEC itself can bring enforcement actions against violating parties.[65] Under Article 9, a wronged party's recourse is only through the civil litigation system, which takes a tremendous amount of time and money.[66]

Additionally, the mandatory-disclosure requirements in the capital markets system provides efficiency because the SEC acts as an independent third party to ensure its rules are properly followed.[67] Article 9 has no such gatekeeper.[68] Additionally, much of the concern relating to the search costs

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60. Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 705 (1988).

61. Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 758 (2006).

62. REV. U.C.C. § 9-502 cmt. 3 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

63. *See supra* note 57.

64. REV. U.C.C. §§ 1-203, 9-620 cmt. 11 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 1999).

65. *See* Ralph C. Ferrara & Philip S. Khinda, *SEC Enforcement Proceedings: Strategic Considerations for When the Agency Comes Calling*, 51 ADMIN. L. REV. 1143, 1173 (1999) (summarizing SEC proceedings).

66. *See* Jens Hausmann, *The Value of Public-Notice Filing Under Uniform Commercial Code Article 9: A Comparison with the German Legal System of Securities in Personal Property*, 25 GA. J. INT'L AND COMP. L. 427, 443 (1996) (citing a study finding litigation costs during 1980–1990 spent on resolving perfection and proper filing to exceed $30 million).

67. *See* Marshall J. Breger & Gary J. Edles, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 ADMIN. L. REV. 1111, 1137 (2000) (observing that Congress included the SEC in a list of independent agencies).

68. *See* Donald J. Rapson, *Default and Enforcement of Security Interests Under Revised Article 9*, 74 CHI.-KENT L. REV. 893, 896 (1999) (discussing secured parties enforcing their rights through contract law rather than turning to a regulator).

of a subsequent creditor deals with a hypothetical, as there may never be a second creditor who incurs search costs to locate which of the debtor's property is specifically secured by the prior creditor. The system of notice-inquiry allocates the costs of acquiring information to the subsequent creditors when they actually materialize, rather than assigning the burden of detailed disclosure to the debtor or initial creditor.

IV. Proposals for Reform

Despite the faults of the Revised Article 9 filing and financing-statement system this Note discusses, the notice-inquiry model is not without its strengths. With this in mind, this Note proposes two modest reforms to address the problems of ambiguity, chilling the debtor's access to credit, and additional search costs while allowing much of the Article 9 financing filing system to remain unchanged. These two proposals are to require signatures on generic financing statements (while continuing to permit specific financing statements to be filed unsigned) and to expand debtor remedies so they have recourse against creditors who are either unwilling or slow to terminate a generic filing statement.

A. Require Signatures for Generic Financing Statements

Revised Article 9 eliminated the need for debtors to authenticate financing statements in the interest of facilitating electronic, paperless filing. In situations where the financing statement is appropriately limited to the collateral represented by the security agreement, this new requirement appears efficient. However, when the financing statement's collateral description is generic or supergeneric, it would be better policy to require the debtor to authenticate the document before it is filed and becomes enforceable.

As the above discussion demonstrates, even though a broad financing statement cannot expand the coverage of the underlying security agreement, the financing statement still has wide-reaching effects on the debtor: subsequent extensions of credit can relate back to the date of the original, the creditor's refusal to terminate can chill the debtor's access to credit, and the debtor has a difficult burden in proving damages caused by a broad description. Subsequent creditors are also affected, as a misreading or misinterpretation of a vague or confusing financing statement may lead the creditor to believe he is more secured than he actually is.

Requiring the debtor to authenticate these broad financing statements would help draw attention to the generic language and make both debtor and creditor aware of the consequences. The debtor will be told that he must sign off on a financing statement only where there is a generic or supergeneric description, and this contrast against other financing statements where he is not required to authenticate may educate debtors on the possible consequences of broad descriptions. The authentication also helps convey the parties' intent in allowing the secured party to have an interest in more than just the collateral as described in the security agreement. This puts subsequent creditors who review filed financing statements on unquestionable notice that the debtor's assets may be generally encumbered, that further inquiry is needed, and that they should not lend without determining what interests a prior creditor may have.

However, a problem with this suggested reform is that an additional sudden requirement in notice-filing might cause a disruption to the filing office's practices. Article 9 provides certain protections insulating the filing offices from responsibility, including a rule that the failure of the filing office to properly index a record does not affect the effectiveness of that filing.[69] Thus, it would make no logistical sense for the filing offices to read records and determine if filing statements with generic descriptions are properly signed. This would become the responsibility of the creditors to manage, which might lead to litigation about whether a document was truly authenticated or not. For example, there might arise disputes about the intent of the parties and whether the debtor truly understood the importance of his actions in giving his signature.

Despite the interruption to the currently existing filing process, given that the intention behind this proposed reform is to return some bargaining power to the debtor and to make them understand the consequences of generic filing statements, forcing the parties to come to agreement about what is filed may be desirable for policy objectives. Requiring the debtor's signature would facilitate negotiations between the parties. If a creditor intending to become a secured creditor seeks a broad interest in all of the debtor's assets, then the mandatory signature requirement would draw the debtor's attention to the provision and make him aware of the implications. For example, if the debtor knows he will seek further lines of credit from other creditors in the future, he might hesitate to provide consent on a supergeneric financing statement.

Another possible rebuttal to this proposal is that the requirement of signatures does not ensure future secured creditors will be put on notice. However, under this construct, the debtor would be providing his explicit consent to the supergeneric financing statements, so the duty should be relegated to the debtor to make future secured parties aware of the interest in "all" of his property. Secured creditors could, for example, ask their debtors whether they have ever given their consent and signed off on a supergeneric financing statement. If the debtor answers in the affirmative, the secured creditor could adjust his risk profile through his own security interest or in the interest rates. If the debtor is untruthful and the secured creditor extends credit on the basis of this fraud, then the secured creditor could bring suit

69. REV. U.C.C. § 9-517 (AM. LAW INST. & NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1999).

against the debtor for any future damages that arise. This would be more equitable to all the secured creditors and ensure subsequent lenders are making business decisions based on the knowledge they have, and they are protected if credit is extended based on deception.

Thus, because the requirement of the debtor's signature to show that he authorized a supergeneric financing statement covering all or substantially all of his property would both provide for more bargaining power and leverage for the debtor as well as the possibility of notice for future secured creditors, the inconvenience of modifying the existing filing system is a cost that can be absorbed. The potential equitable benefits would be worth any disruptions to the currently existing system.

B. Expand Debtor Recourse

However, because Revised Article 9 has already been adopted for more than fifteen years and the prospect of another reform may be unsavory to contemplate, another alternative method of reform may be preferable. This would be to provide debtors with more control over terminating financing statements once their debts are repaid or allowing them to file legally meaningful explanatory or information statements. As the *Dough Boys* plaintiffs demonstrated, a broad financing statement has the potential to complicate an acquisition, and a knowledgeable party can use that complication to leverage financial compensation for a release they should have given anyway.

Allowing debtors to bring suit against creditors who refuse to terminate would reduce this problem. A statutory provision in the U.C.C. could allow debtors to sue creditors who refuse to terminate their financing statements thirty days after the debtor makes a request following payment in full of the debt. Structuring the private cause of action in this manner would allow only conscious debtors to bring suit, so creditors such as banks do not have to constantly check the status of their extended loans. Giving the creditor thirty days to act before the debtor can bring suit allows for the creditor to make sure the loan has indeed been fully paid and to prepare the termination documents. If the creditor does not comply with this provision, damages awarded to the debtor should be based on an initial amount of $500, reflecting the current Article 9 provisions in § 9-625, but increase based on (1) the length of time that passes while the creditor does not terminate the financing statement; (2) the amount of the loan and the value of the collateral (both as an absolute and as an amount relative to the rest of the debtor's assets); and (3) the impact on the debtor's ability to find alternative financing. This should be a question of fact determined by a trial judge or jury with the possibility of awarding punitive damages against a creditor who behaves egregiously.

This possible amendment's advantage over an attempt to change the Article 9 filing system itself has to do with its ability to maintain current business practices. Requiring the debtor to sign off on generic financing statements might lead to delays in creditors filing financing statements and, thus, perfecting their interests. Under this proposal, secured parties would be able to file the financing statements according to their own timelines without having to wait for the debtors' approval. A statutory provision matching the expectations of creditors and debtors merely restates the debtors' already existing right to bring suit and provides guidance to creditors on when they need to act. This revision would also incentivize creditors to file termination statements promptly so they can avoid the prospect of litigation.

Another advantage this proposal has is the structure of the penalties. When parties such as the *Dough Boys* plaintiffs engage in extremely important transactions, creditors with perfected financing statements may be able to leverage their hold over the assets to extract a larger settlement payment than is necessary. In general, the larger the collateral and loan, the greater the importance for the parties transacting. However, outside the business context and in the consumer goods context, loans for several thousands of dollars may be the most important transaction a family or individual consumer undertakes, which is why this proposal would also have the fact finder consider the relative worth of the loan compared to the rest of the debtor's assets. This proposal thus seeks to compromise between preserving the interests of high-worth creditors and low-worth debtors, and everyone in between.

V. Conclusion

The Revised Article 9 made several changes to the prior versions of the Uniform Commercial Code, including expanding the range of acceptable collateral descriptions used in financing statements. While this move was made to ease the burden on creditors and to allow for paperless filing, these changes have also caused unexpected consequences. Generic and supergeneric descriptions can be ambiguous, can create a "stranglehold" over debtors' credit, and can be an inefficient way to allocate the burden of searching. However, there are strengths of such a notice-inquiry system as well, and this Note's proposed modifications have kept that in mind. This Note proposes a future amendment to the U.C.C. to provide an explicit, statutory private right of action allowing debtors to bring suit against creditors for overbroad statements if their debts are repaid. Perhaps in the future, drafters can consider the wisdom of allowing overbroad collateral descriptions.