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Practice Group:

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U.S. Bankruptcy Court Reminds Us to "Get the Note" or File a Financing Statement

By Brandy A. Sargent

In a recent opinion, the U.S. Bankruptcy Court for the District of Oregon reminds all finance lawyers (and participants trying to document a finance transaction without legal assistance) that recording an "assignment" of a deed of trust is not always sufficient to perfect an interest in the real property.

Back in the heady days just before the Great Recession, a real estate speculator ("Speculator") engaged in a series of transactions related to residential property in Oregon (the "Property"). Speculator sold the Property to Buyer 1 who, pursuant to a seller financing arrangement, executed a promissory note and deed of trust in Speculator's favor. The deed of trust was recorded ("DOT1"). Speculator then borrowed money from an investor ("Lender") and executed a promissory note in Lender's favor and an assignment of DOT1 (together with the note it secured) in favor of both Speculator and Lender. Buyer 1 defaulted, and Speculator took back ownership of the Property in connection with the default. He then negotiated to sell the Property to Buyer 2 and, again, to take back a promissory note and deed of trust pursuant to a seller financing arrangement. Lender agreed to release his interest in DOT1 to facilitate the sale, taking a similar interest in the new transaction with Buyer 2. The sale closed in early 2010, and Buyer 2 executed a promissory note (the "Note") and deed of trust in Speculator's favor ("DOT2"). Shortly afterward, an assignment of DOT2 (which also assigned the Note) was recorded in favor of Speculator and Lender. Buyer 2, like Buyer 1, did not perform, but quit claimed the Property back to Speculator (as a sort of deed in lieu of foreclosure). Speculator (who was himself by then in default under his own obligation to Lender) did not tell Lender about the quitclaim. In 2015, Speculator commenced a Chapter 7 bankruptcy.

Speculator's Chapter 7 trustee filed suit against the Lender. The theory? Under Section 544 of the U.S. Bankruptcy Code, the Trustee acts as a "bona fide purchaser of real property" and was entitled to a determination that Lender, notwithstanding the assignment of DOT2, was unsecured.

In Huffman v. Gollersrud[1], the Bankruptcy Court agreed. The judge determined that Lender did not have a lien on the Property itself but rather a security interest in the Note. Based on testimony of the parties, the court determined that the assignment of DOT2 was not a sale or an absolute transfer of DOT2, but rather was given as security — a "collateral assignment." This distinction created an Article 9 Uniform Commercial Code ("UCC") security interest in the Note, not an interest in the Property that also secured the Note. Therefore, in order to properly perfect his security interest, Lender needed to either take possession of the Note (UCC 9-312) or file a financing statement (UCC 9-313). Because Lender did neither, he was unsecured, and the Chapter 7 trustee took priority as a fictional bona fide purchaser.

[1] Adv. No. 16-6018 (Feb. 13, 2017).

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This case is good reminder that not all assignments are absolute. If an assignment of personal property is given for security, it may come within Article 9 and become subject to the UCC perfection rules. If the transaction you are working on could even conceivably be viewed as a "collateral assignment," consider all necessary means of perfecting the transaction.

Authors:

Brandy A. Sargent
brandy.sargent@klgates.com
+1.503.226.5735