

## CLIENT ALERT

### Criminal Borrower? An Innocent Secured Creditor Need Not Worry About Losing Its Collateral to Government Forfeiture

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Article 9 of the Uniform Commercial Code provides comfort to secured creditors faced with threats from parties asserting superior claims to or lien rights in the secured creditor's collateral. But certain federal statutes may intersect with and disrupt the otherwise applicable Article 9 priority scheme. The U.S. Government's power to seize assets subject to criminal forfeiture is one such example of this intersection. In a recent decision, the U.S. Court of Appeals for the Sixth Circuit vindicated an innocent secured lender's lien rights when its borrower's assets were subject to criminal forfeiture in favor of the government. In *United States v. Huntington National Bank*, 682 F.3d 429 (6th Cir. June 14, 2012), the Sixth Circuit ruled that the federal forfeiture statute's protections for a bona fide purchaser for value (BFP) were available to the bank because the bank "purchased" its security interest for valuable consideration, and because the bank had no knowledge of the criminal activity of its borrower at the time the bank obtained its security interest in the assets subject to forfeiture.<sup>1</sup>

In October 2002, Huntington National Bank had extended a multi-million dollar line of credit to Cyberco which was secured by "a continuing security interest and lien" on all tangible and intangible property of the borrower, including "deposit accounts." More than two years later, after discovering a complex scheme by Cyberco's principals to defraud dozens of lending institutions, the federal government seized \$4 million in Cyberco assets. Those assets included more than \$700,000 held in a deposit account at Huntington, an asset in which Huntington asserted its security interest.

After receiving notice of the criminal forfeiture action, Huntington filed a verified petition of claim under the federal forfeiture statute. In that claim, Huntington asserted that it had a right to, and a direct ownership interest in, the funds in the account. Huntington's position was based upon an exception in the forfeiture statute that protects a BFP of property if the BFP was "at the time of purchase reasonably without cause to believe that the property was subject to forfeiture . . . ." 21 U.S.C. §§ 853(c) and 853(n)(6)(B). In opposing the bank's claim, the government argued that the exception must be read and applied narrowly and, unless the third party claimant can fit squarely within the exception, the third party claim must be denied. Specifically, the government challenged: whether a security interest obtained by a lender is the equivalent of a "purchase;" whether a secured creditor can be a "bona fide purchaser;" and whether the federal statute's concept of "property" includes "intangible" property.

The Sixth Circuit concluded that an Article 9 security interest is a subset of "purchase"<sup>2</sup> and that a security interest in intangible property is of a type that Congress intended to be protected by the exception in the forfeiture statute. The court had no difficulty finding that Huntington gave "value" in the form of a loan and concluded that Huntington was eligible to be a BFP. The court also noted that "Article 9 of the UCC does not use express BFP terminology, but the system of perfection and priority found in Article 9 exemplifies the common law BFP concept." The Sixth Circuit then considered the "innocence" aspect of the BFP forfeiture exception. The court noted that the government had stated at the forfeiture hearing before the district court that Huntington was not complicit in the fraud and had "no knowledge of the fraud." The court also explained that in an earlier appeal the government had conceded in a pre-hearing brief that all claimants were unaware of the borrower's criminal activity.

As a result, the court found that the government had conceded this issue and that Huntington's collateral was protected under the BFP exception to forfeiture.

While it should be an unusual circumstance for a creditor to have a obligor's assets threatened by a criminal forfeiture action, a forfeiture could be devastating to an unprotected creditor if an obligor turned criminal. Becoming a perfected Article 9 secured creditor is a way for the innocent creditor to minimize risks associated with the government seeking forfeiture of the criminal actor's assets.

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<sup>1</sup> On July 31, 2012, the mandate of the Sixth Circuit issued after the government elected not to petition for rehearing or rehearing *en banc*.

<sup>2</sup> Although not addressed in the decision, we note that the general definitions section of Article 1 of the UCC, which is applicable to all other Articles of the UCC, defines "Purchase" to include "taking by . . . security interest . . ." and a "Purchaser" as "a person who takes by purchase." UCC §1-201(29) and (30)(West 2011-2012 Edition).

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