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BANKING UPDATE

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TAKING A SECURITY INTEREST IN A LIQUOR LICENSE

By Gladys Goschka

A liquor license can be a very valuable piece of collateral. For example, when the Bronze Door, a restaurant located in Grosse Pointe Farms, closed its doors and filed for bankruptcy, it had two valuable assets. The first was the front door, which was solid bronze, and the second was its liquor license. The market value of a license is based on many factors. In areas such as Grosse Pointe Farms where the number of licenses is limited, the market value of the license can be very high.

Obtaining a lien on a liquor license has not always been straight forward in Michigan, however, and the enforceability of such a security interest has not always been clear. Prior to 1994, Rule 19 of the Michigan Liquor Control Commission ("MLCC") specifically prohibited security interests in liquor licenses. Under Rule 19, a retail licensee could not include a liquor license or alcoholic liquor in a security agreement or in a financing statement. This put secured parties in the untenable position of having to violate the rule in order to perfect a lien.

As was to be expected, secured parties and sellers of retail licensed businesses attempted to protect themselves through agreements to assign, or reassign, the license upon default. The assignments were used to avoid the security agreement ban, but problems arose when the secured party attempted to enforce these agreements in bankruptcy proceedings without having perfected the security interest. Although some bankruptcy courts used their equitable powers to find an equitable lien enforceable in bankruptcy,

other bankruptcy courts adhered to the priority rules set forth in the Uniform Commercial Code ("UCC"), ruling against the secured party. These courts found the assignment/reassignment agreements were in actuality security agreements, and the failure to file a financing statement left the lien unperfected. It was not until Rule 19 had already been amended that the Michigan Supreme Court addressed the issue in *Brown v. Yousif*, 445 Mich. 222, 517 N.W.2d 727 (1994). In that case, the Court held Rule 19 invalid to the extent that it conflicted with Article 9 of the UCC, a law of general applicability. As noted, however, the MLCC had already amended Rule 19.

Currently Rule 19 only prohibits a retail licensee from including alcoholic liquor in a security agreement or financing statement. The ban on including the license in the security agreement or financing statement has been deleted. Michigan Administrative Code Rule 436.1119. Now upon a foreclosure of the security interest, the transfer of the liquor license is still subject to the consent of the MLCC, but perfecting the lien is no longer an issue. So secured parties have come full circle, and the assignment/reassignment subterfuge is no longer needed.

Nevertheless, when taking a liquor license as collateral, the secured party should consider the special nature of the license. Any transfer of the liquor license before or after a default is subject to the provisions of the Michigan Liquor Control Code MCL 436.1101-.2301 as well as the MLCC's administrative rules. The secured party

"Rule 19 ...specifically prohibited security interests in liquor licenses."

will have to work with the MLCC within this framework, and obtain its consent to any transfer, and such transfers can take months to be approved.

The MLCC issues a number of different licenses. These include licenses for the manufacture and distribution of beer, wine and liquor as well as licenses for the on site sale of beer, wine and liquor. If a lender is financing a business involved in the manufacture, distribution or retail sale of liquor, the liquor license should definitely be part of the collateral mix. First, obtain a copy of the license to verify that it is held by your borrower. The license itself is classified as a general intangible under the UCC and to perfect the lien, the secured party should obtain a security agreement from the owner of the license and file a financing statement that includes the license in the description of collateral.

Also, the secured party must keep in mind that Rule 19 still prohibits a retail licensee from including alcoholic liquor in a security agreement or financing statement. Consequently,

if a secured party takes a security interest in inventory, the description must specifically exclude alcoholic liquor inventory. Even in situations where a security interest can be taken in such inventory, such as a wholesale distributor's inventory, the MLCC must be contacted for its approval.

Similar issues can arise in other regulated industries, such as broadcasting, where a license issued by the Federal Communications Commission may constitute the most valuable asset of a radio or television station or a personal communications service. For many years, taking a security interest in such a license was prohibited. Today the courts hold that the FCC may not prohibit taking a security interest in the proceeds of a license. Lending to companies doing business in other regulated industries may raise similar issues. Consulting with qualified counsel before documenting these transactions may save considerable grief for the prudent lender.



Gladys M. Goschka

Gladys Goschka, a Senior Attorney with Simon Galasso & Frantz, PLC, practices banking and commercial finance law. She was formerly a Vice President with Standard Federal Bank/Michigan National Corp., and a Vice President with Bank One/NBD Bank. She can be reached at (248) 649-1400 x122 or ggoschka@sgfattorneys.com

Admitted to bar: 1982, Michigan; 1982, United States District Court for the Eastern District of Michigan; 1982, United States Court of Appeals for the Sixth Circuit.

Education: Michigan State University (Bachelor of Arts, with honors, French and Education, 1969); Wayne State University (Post-graduate Certification: Spanish Teaching Minor, 1978); University of Detroit School of Law (Juris Doctor, Magna Cum Laude, 1982). Executive Editor, University of Detroit Journal of Urban Law, 1981-1982.

Simon, Galasso & Frantz, PLC

<http://www.sgfattorneys.com>

2401 W. Big Beaver Road

Suite 520

Troy, MI 48084

Phone: (248) 649-1400

Fax: (248) 649-9949

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