MEMORANDUM

To: Members of the Article 9 Joint Review Committee, Advisors and Observers

From: Edwin E. Smith, Chair

Date: September 8, 2008

Re: October 3-5, 2008, meeting of the Article 9 Joint Review Committee

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The Article 9 Joint Review Committee will meet October 3-5, 2008, in Chicago to discuss the issues list created by the initial Article 9 review committee created by the Permanent Editorial Board of the Uniform Commercial Code. The agenda for the meeting, the issues list and supplemental materials are attached.

The meeting will take place at the Embassy Suites Hotel, Downtown Lakefront, 511 North Columbus in Chicago. You should have already received the meeting notice from the ULC office. We will start promptly at 9 am CT on each of Friday, Saturday and Sunday. We hope to conclude by 5:30 pm CT on Friday and Saturday and by noon on Sunday.

The discussions will be largely confined to the issues list. As the agenda indicates, the discussion of the filing issues will take place on Saturday, October 4.

I wanted to remind everyone that the Article 9 Joint Review Committee intends to confine its work to the issues raised on the issues list. Among the standards that the initial Article 9 review committee used in developing the issues list are:

- The committee would not recommend changes that would alter policy decisions made during the 1998 revision unless the current provisions appear to be creating significant problems in practice, and, if so, it would note that the recommended revision may involve a policy change.

- Recommendations for statutory change would focus on issues as to which ambiguities have been discovered in existing statutory language, where there are substantial problems in practice under the current provisions, or as to which there have been significant non-uniform amendments that suggest the need to consider revisions.

- The committee has recommended that an issue be handled by a revision to the Official Comments whenever it thought that in fact the statutory language was sufficiently clear and produced the desired result, but that judicial decisions or experience in practice indicated that some clarification might be desirable.

The issues list presents a full agenda for the Article 9 Joint Review Committee. Any issue that any of you may wish to raise that is not identified on the issues list will be given secondary consideration by the Joint Review Committee. If the Joint Review Committee believes that the issue deserves further consideration, it will need to seek approval from the sponsoring organizations - the American Law Institute and the Uniform Law Conference - before proceeding with any further consideration. It is the hope of the Joint Review Committee that, absent extraordinary circumstances, it will not be seeking such approval.

We welcome all of you and look forward to a very productive meeting.

ARTICLE 9 REVIEW COMMITTEE

Statutory Modification Issues List

This list summarizes issues that suggest possible statutory modifications to the Official Text of Article 9 of the Uniform Commercial Code. The issues were identified by the Article 9 Review Committee for consideration by a drafting committee if the Uniform Law Conference and the American Law Institute decide to appoint one. The list was formulated by the Review Committee in telephone conferences held on April 14, April 23, May 12, May 27, June 9 and June 16, 2008.

The list first sets forth issues relating to filing. It then proceeds to set forth issues that have arisen in case law. It next sets forth issues that are suggested by non-uniform amendments unrelated to filing. The list then sets forth other issues.

At the end of the list are additional issues suggested by the Review Committee for consideration as modifications to the Official Comments to Article 9. These are issues that the Review Committee did not believe needed to be addressed by statutory modifications but which the Review Committee thought might be usefully addressed by modifications to the Official Comments, presumably within the prerogative of the reporter appointed for the drafting committee.

Each issue listed, whether suggested as an issue to be addressed in the Official Text or as an issue to be addressed in the Official Comments, is followed by a brief explanation of the issue.

I. FILING ISSUES

A. Debtor name

1. *Individual debtor name*

Issue: Whether Article 9 should provide a more certain rule to determine the name of a debtor who is an individual.

Explanation: Section 9-502(a)(1) provides that a financing statement must, among other requirements, provide the name of the debtor in order for the financing statement to be sufficient. Section 9-503(a)(4)(A) states that, if the debtor is an individual who has a name, the financing statement must provide the individual debtor's name. Because under § 9-519 financing statements are indexed by the filing office of each state under the debtor's name, a subsequent searcher will need to know under what debtor name to search for a financing statement. Accordingly, § 9-506 provides that a financing statement is seriously misleading, and is therefore ineffective, if the financing statement provides a debtor name other than the name required by§ 9-503(a)(4)(A) unless a search under the required name, using the fling office's standard search logic, will disclose the financing statement.

Article 9 tells us what the debtor's name is if the debtor is a corporation or other registered organization. Under § 9-503(a)(1) that name is the name of the organization indicated on the public record of the debtor's jurisdiction of organization. However, Article 9 does not tell us what the debtor's name is if the debtor is an individual. And courts, in interpreting §§ 9-503(a)(4)(A) and 9-506, have struggled in determining whether a particular financing statement that contains the debtor's name as reflected on his or her birth certificate, driver's license, passport or other identification, or even a debtor's nickname or commonly used name, is the correct name of the debtor for the financing statement to be sufficient.

Recently, several states - Nebraska, Tennessee and Texas - have passed non-uniform amendments to their Article 9 to attempt to resolve this issue. Nebraska has enacted legislation to the effect that a financing statement containing the debtor's last name is sufficient.[1] Tennessee[2] and Texas permit the name of the debtor as reflected on his or her driver's license to be sufficient.

If a drafting committee considers a uniform statutory solution for determining the name of an individual debtor for purposes of satisfying the sufficiency requirements for a financing statement, that solution would logically apply as well to the sufficiency on a financing statement of the name of an individual who is a trustee or a settlor of a trust for purposes of § 9-503(a)(3) or who is a decedent for purposes of § 9-503(a)(2).

2. *Registered organization name*

Issue: Whether Article 9 should further define the public record indicating the name of a debtor that is a registered organization.

Explanation: Under § 9-503(a)(1) a financing statement sufficiently provides the name of a debtor that is a registered organization only if it provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization. However, some states maintain more than one public record showing a debtor's name. For example, a state may maintain as a public record the charter document of the organization, and it may also maintain as a public record an on-line searchable data base for organizations of the same type. For a variety of reasons, the debtor's name in one public record may vary from the debtor's name in another public record. The International Association of Commercial Administrators ("IACA") has proposed that states amend Article 9 to provide that the name of the debtor as set forth in its charter document be determinative.

The resolution of this issue may also relate to the definition of "registered organization" in § 9-102(a)(70). The definition states that a "registered organization" is "an organization organized solely under the law of a single State or the United States and as to which the State or the United States *must maintain* a public record showing the organization to have been organized" (emphasis added). Most state public records laws were written without Article 9 in mind. Thus, in many states the duty of the state to maintain public records relating to organizations is not always clear, even if the state does in practice maintain the public records. Because the public record that provides the debtor's name for purposes of § 9-503(a)(1) would likely be the public record that the state "must maintain" for

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[1] A subsequent amendment delayed the effective date of the Nebraska legislation for an additional year.

[2] Tennessee's amendment initially permitted the debtor's name as reflected on any of several identification documents to be sufficient, but the legislation was subsequently amended to follow the Texas approach..

the organization, consideration might also be given to providing a further explanation of the "must maintain" reference in the definition, perhaps in an expanded Official Comment if not in the definition of "registered organization" itself.[1]

3. *Trust name*

Issue: Whether § 9-503(a)(3) should be stated expressly not to apply to a business trust that is a registered organization.

Explanation: Section 9-503(a)(3) sets forth the rules for determining the name of a debtor that is a trust or a trustee acting with respect to property held in trust. However, it is possible that a trust may be a business trust that is itself a registered organization. In that case, there has been some confusion in practice as to whether the debtor's name should be determined under § 9-503(a)(3) or, alternatively, under § 9-503(a)(1) which provides the rules for determining the name of a registered organization. While the Review Committee believes that the better interpretation is that the debtor's name should be determined under the registered organization rules, Delaware has enacted a non-uniform amendment that makes this result clear under the statute.

B. Transmitting utilities

Issue: Whether a filing designating a debtor as a transmitting utility must be made in the initial financing statement.

Explanation: Section 9-515(f) permits a financing statement to designate a debtor as a transmitting utility. If the debtor is so designated, the financing statement does not have a specific lapse date. Instead, the financing statement is effective until a termination statement is filed.

Because the definition of "financing statement" in § 9-109(a)(39) includes all amendments relating to the financing statement, filing offices have had to address the filing of an amendment designating the debtor as a transmitting utility when the initial financing statement did not designate the debtor as a transmitting utility. In such a case, a filing office, which has already given the initial financing statement a specific lapse date, is often not operationally capable, without undue cost or expense, of eliminating the lapse date in order to give effect to the amendment.

IACA has proposed that the states amend § 9-515(f) so that the debtor may be designated as a transmitting utility only in the initial financing statement. The change would make § 9-515(f) consistent with § 9-515(b), which provides a thirty-year lapse date for an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction.

C. Forms

[1] The discussion in this memorandum on debtor names in the context of filing is not intended to suggest that a drafting committee might not consider other debtor name filing issues, such as those relating to foreign individual names, names in foreign alphabets and accented, hyphenated or like names that may challenge a filing office's indexing or search logic. These issues are not highlighted in this memorandum because even understanding them and appreciating whether statutory adjustments may be desirable would require a dialogue with IACA and filing officers in which the Review Committee has not had the time or opportunity to engage.

Issue: Whether the approval of changes to the initial financing statement form and amendment form should be delegated to IACA or to a state's secretary of state.

Explanation: Section 9-521(a) provides that, if a filing office accepts an initial financing statement in written form, it must accept an initial financing statement in the form set forth in that subsection. Section 9-521(b) contains a similar provision for an amendment and also sets forth a statutory form of amendment. Now that the statutory forms of initial financing statement and amendment have been in use since 2001, IACA has recommended a few changes to the forms. To accommodate these and possible further changes over time, IACA has proposed that states amend their Article 9 so that the forms of initial financing statement and amendment would be deleted from the statute and so that IACA itself would approve the forms from time to time. In a state that is not permitted by its constitution or other law to delegate the approval process to IACA, IACA recommends that the state's Article 9 be amended to provide that the forms be approved by the state's secretary of state. The California State Bar UCC Committee has objected to the proposal to amend § 9-521 out of concern that the amendment might result in no single written form of financing statement or amendment being accepted in all states.[4]

D. Correction statement

Issue: Whether the provisions of Article 9 providing for a correction statement should be reexamined.

Explanation: To address concerns about "bogus" filings against a debtor, § 9-518 permits a debtor to file a "correction statement" to indicate that a filed record is incorrect or wrongfully filed. The filing of a correction statement is for informational purposes only. It does not affect the effectiveness of a filed financing statement.

In practice secured parties have attempted to file correction statements even though § 9-518 permits a correction statement to be filed only by a debtor. This practice has often arisen when a secured party's financing statement has been wrongfully terminated by another secured party's termination statement that incorrectly referred to the file number of the financing statement of the first secured party. Of course, under § 9-510 the termination statement, filed without authorization of the first secured party, would be ineffective.

IACA has proposed that states amend their Article 9 so that a correction statement would be capable of being filed by a secured party or by anyone else who was entitled to file the initial financing statement. The California State Bar UCC Committee has objected to the proposal out of concern that the amendment would encourage the filing of extraneous records that do not affect the effectiveness or lack of effectiveness of financing statements, thus "clogging" the records of the filing offices and burdening both filing offices and subsequent searchers.

If the IACA proposal is not considered favorably by a drafting committee, consideration might also be given to whether Sec. 9-518 should be retained. Under other provisions of Article 9, the financing statement is not effective. The correction statement

[4] The California State Bar UCC Committee objection leaves open the possibility that the IACA concerns could be addressed by a modification to the Official Comments to § 9-521.

itself has no legal effect. Even a termination statement would produce only the consequence that the financing statement has become ineffective. That is a consequence that would already be the case for a "bogus filing". Furthermore, non-Article 9 law in various states provides a debtor with some additional remedies, ranging from tort claims for slander of title and the like to judicial procedures by which a "bogus filing" may be removed from the record. In addition, the misuse of the public records and the intentional conduct of the sort involved in making a bogus filing might be a crime under the laws of some states.

II. ISSUES ARISING UNDER CASE LAW

A. Commercial Money Center

Issue: Whether a right to payment on chattel paper, if assigned separately from the chattel paper, should be characterized as chattel paper, a payment intangible or an account.

Explanation: The decision in *In re Commercial Money Center*, 350 B.R. 465 (B.A.P. 9th. Cir. 2006), raised the question of whether a payment right "stripped" from chattel paper was still "chattel paper" or whether the payment right becomes a "payment intangible." The answer is important because the sale of a payment intangible enjoys "automatic" perfection under § 9-309(3), while a buyer of chattel paper, to perfect its interest in the chattel paper, must either take possession or control of the chattel paper or file a financing statement against the debtor covering the chattel paper. In addition, the answer would affect certain priority rules, such as the "super-priority" in favor of certain purchasers of chattel paper who take possession or control of the chattel paper. *See* §§ 9-330(a) and (b).

The existing Official Comments to Article 9 are inconclusive on the characterization issue. *Compare* § 9-109, Official Comment 5 *to* § 9-102, Official Comment 5.d. There is also a question as to whether the problem is limited to "true lease" chattel paper given that § 9-203(g) would already appear to address chattel paper in which the payment right is secured by a security interest. That section provides that a security interest securing a payment right is transferred with the payment right and would support a characterization that the payment right, when transferred, is still chattel paper unless perhaps the security interest is disclaimed by the transferee.

If a drafting committee determines that a payment right "stripped" from chattel paper should not be characterized as chattel paper, it might consider whether the payment right should be characterized as an account instead of a payment intangible.

The *Commercial Money Center* decision has created priority concerns for chattel paper purchasers in practice, and the California State Bar UCC Committee has urged that the PEB address the issue.

B. Highland Capital

Issue: Whether the definitions of "promissory note" and "security" may need to be clarified so that a conventional promissory note issued as part of a class or series is not viewed as a security.

Explanation: In its decision in *Highland Capital Management v. Schneider*, 866 N.E.2d 1020 (N.Y. 2007), the New York Court of Appeals concluded that promissory notes that were part of a class or series constituted "securities" under § 8-102(a)(15). In order to reach that conclusion, the court found that the promissory notes were represented by certificates "the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer" as required by §8-102(a)(15)(i). The court came to this conclusion even though the issuer maintained no transfer books, because, as the dissent put it, "it is always theoretically possible there could be books on which transfers of anything could be registered."

While technically the decision involves an Article 8 rather than an Article 9 issue, the decision influences the characterization of collateral under Article 9. The decision has created confusion in Article 9 practice as to the proper characterization of some types of promissory notes and even "uncertificated' certificates of deposit.

Presumably, if the drafting committee were to consider addressing the *Highland Capital* decision, it would consult with those at the Uniform Law Conference and the American Law Institute who were active in the drafting of Article 8.

III. ISSUES SUGGESTED BY NON-UNIFORM AMENDENTS UNRELATED TO FILING

A. Control of a deposit account or securities account

Issue: Whether the methods of obtaining control of a deposit account or securities account should be expanded.

Explanation: Delaware amended its §§ 9-104, 9-106 and 8-106 effective July 2007 to provide additional methods for a secured party to achieve control of a securities account and a deposit account and to clarify that the additional methods of control do not impose any implied duties not expressly agreed to by the securities intermediary or the depositary bank. New Delaware § 9-104(a)(4) provides an additional method for the secured party to achieve control: the authentication by the debtor, secured party and securities intermediary of a record that (i) is conspicuously denominated a control agreement, (ii) identifies the specific deposit account, and (iii) addresses the disposition of the funds in the deposit account or the right to direct such disposition. Parallel provisions were added to §§ 8-106(c) and 8-106(d) for uncertificated securities and securities entitlements. New Delaware § 9-104(a)(5) provides an additional method for the secured party to achieve control of a deposit account where the name on the deposit account is the name of the secured party or indicates that the secured party has a security interest in the deposit account, thus not requiring that the secured party become a customer of the bank. A parallel provision was added to § 9-106(d) for securities accounts.

To the extent that an expansion of the methods of control, along the lines of the Delaware amendments, would allow a secured party to achieve control, even if the secured party is unable, without further action by the debtor, to direct the disposition of security entitlements from the securities account or funds from the deposit account, the expansion may reflect a policy change that would need to be justified.

B. Location of a federally registered organization

Issue: Whether § 9-307(f)(2) should be modified to state more completely how federal law may designate the location of a debtor that is a registered organization organized under federal law.

Explanation: 9-307(f)(2) locates a registered organization organized under the law of the United States "in the State that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its State of location." Official Comment 5 to § 9-307 notes that banking law often permits a registered organization to designate a main office, home office, or other comparable office, and states that "[d]esignation of such an office constitutes the designation of the State of location for purposes of Section 9-307(f)(2)."

Delaware has adopted a non-uniform version of § 9-307(f)(2) that adds a sentence in the text of the statute similar in substance to the quoted portion of Official Comment 5: "For purposes of paragraph (2) above, if a registered organization designates a main office, a home office, or other comparable office in accordance with the law of the United States, such registered organization is located in the State that such main office, home office, or other comparable office is located."

The basis for the non-uniform amendment is that a literal reading of the statute itself would not provide a clear rule for the location of a national bank, because the National Bank Act does not, in terms, authorize a bank to designate "its State of location." As the issuance of Official Comment 5 indicates, the Article 9 drafters understood this point. The Delaware legislature, however, sought to provide more definitive treatment by putting this material in the statute.

The issue often arises in practice, especially opinion practice.

IV. OTHER ISSUES

A. General provisions

Issue: Whether the definition of "authenticate" should be conformed to the definition of "sign" in Article 7 (as well as the unenacted revisions to Articles 2 and 2A) insofar as the latter definition applies to electronic forms of signing.

Explanation: The definition of "authenticate" in § 9-102(a)(7) indicates that the term means not only to sign (as that term is defined in Article 1) but also "to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record." The second portion of this definition is not entirely consistent with the parallel provision in the subsequently-drafted definitions of "sign" in Articles 2, 2A, and 7. In those definitions, drawn from the Uniform Electronic Transactions Act and the federal Electronic Signatures in Global and National Commerce Act (E-SIGN), the relevant language provides that to sign means "with present intention to authenticate or adopt a record, … to attach to or logically associate with the record an electronic sound, symbol, or process."

There are several differences between the Article 9 definition and these later definitions. Most notably, only Article 9 requires that the authenticating person/signer take its action with the intent "to identify the person." It does not appear that the drafters of the subsequently-drafted Articles intended to cover different circumstances than did the drafters of Article 9. Rather, it appears that the subsequent Articles reflected an effort to define the term more precisely.

Presumably, if the drafting committee were to consider addressing the definition of "authenticate", it would consult with those at the Uniform Law Conference who were active in the drafting of the Uniform Electronic Transactions Act and those at the Uniform Law Conference and the American Law Institute who were active in the drafting of the Article 2 and 2A amendments and the Article 7 revisions.

Issue: Whether the definition of "certificate of title" should be modified to include a "security-interest statement" as defined in the Uniform Certificate of Title Act (UCOTA) or a similar concept.

Explanation: Under UCOTA, the term "security-interest statement" includes a record created by a secured party that indicates a security interest. The security-interest statement, when filed with the state's motor vehicle office, may be used to perfect the security interest even if, contrary to another provision of UCOTA, the motor vehicle office issues a certificate of title that does not indicate the security interest. The UCOTA perfection approach creates a possible tension with § 9-311(a)(2), which defers to certificate-of-title statutes that provide for a security interest to be "indicated on the certificate as a condition or result of perfection."

Issue: Whether the definition of "registered organization" should be clarified as to include or exclude a business trust that is not created by the filing of a record with the Secretary of State's office.

Explanation: Consistent with other suggested changes regarding clarifying how to treat business or statutory trusts,[5] the definition of "registered organization" could address more clearly the distinction between business trusts that are created by the filing of a record with a state's secretary of state to create the business trust and common law business trusts that are not initially created by the filing of a record but may subsequently register with the secretary of state to indicate limited liability for the trustees and beneficiaries. The issue often arises in practice and has been mentioned by a representative of IACA in informal discussions.

Issue: Whether § 9-105 should be modified to conform to § 7-106 and UETA § 16.

Explanation: Section 9-105 creates a control test applicable to electronic chattel paper. After it was drafted, UETA created a somewhat different formulation which was followed in revised Article 7 at § 7-106. In particular, the UETA and Article 7 approaches provide a general test and a safe-harbor rule; § 9-105 does not provide a general test.

Presumably, if the drafting committee were to consider addressing § 9-105 in this respect, it would consult with those at the Uniform Law Conference who were active in the drafting of the Uniform Electronic Transactions Act and those at the Uniform Law Conference and the American Law Institute who were active in the drafting of the Article 7 revisions.

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[5] *See* Part I.A.2 and 3, *supra*.

B. Attachment

Issue: Whether § 9-210 should be expanded to require the secured party to provide a "pay off" letter as of a date designated in a request by the debtor so long as the secured party receives the request within a period, consistent with the periods in current § 9-210, of not less than 14 days before the date designated.

Explanation: Section 9-210 permits the debtor at any time to request from the secured party a statement of account or a list of collateral. The secured party has 14 days to respond. Anecdotal evidence indicates that the section is seldom used in practice. More typical would be for a debtor to request a "pay off" letter as of a specific date so that the debtor may refinance the secured obligations on that date. A drafting committee might consider expanding § 9-210 to impose on a secured party the obligation to provide a "pay off" letter to the debtor as of a date designated by the debtor so long as the debtor's request allows the secured party an identical period of at least 14 days following the debtor's request to provide the pay-off letter.

If the drafting committee decides to address § 9-210 in this respect, it might consider whether any change to § 9-210 would require amendments to the "safe harbor" notice forms in §§ 9-613 and 9-614.

C. Perfection

Issue: Whether purchase-money status should extend to consumer-goods related intangibles other than software and, if so, whether a purchase-money security interest in intangible collateral related to consumer goods should be automatically perfected.

Explanation: Frequently purchase-money transactions in consumer goods involve the extension of credit for the cost of extended warranties, maintenance services, insurance and other intangibles in addition to the consumer goods that are the focus of the underlying transaction. When the collateral is repossessed, the secured party may also have a claim for rebates due for early termination of the intangible property. In motor vehicle financing, the security interest in the primary collateral is perfected under state certificate-of-title statutes. The purchase-money security interest in other consumer goods is perfected automatically under § 9-309(1). However, any intangibles for which purchase-money credit was extended are not "consumer goods". They do not enjoy purchase-money status and are not covered by the automatic perfection provisions of § 9-309(1).[6]

To the extent that purchase-money status or the scope of automatic perfection is expanded to encompass intangible collateral related to consumer goods, the expansion may reflect a policy change that would need to be justified.

D. Priority

Issue: Whether § 9-317(d) should be expanded to cover commercial tort claims and perhaps also other collateral not addressed in § 9-317(b) or (d) and for which a trading market might exist.

[6] Warranty payments relating to consumer goods may be proceeds, but the proceeds security interest would generally be perfected for a period of only 20 days without further action being taken by the secured party to extend the perfection period. *See* §§ 9-315(c) and (d).

Explanation: Section 9-317 provides the rules governing priority between an unperfected security interest and a competing claim to the collateral. As a general matter, buyers of collateral who give value (and, in the case of tangible collateral, receive delivery) without knowledge of an unperfected security interest take free of the unperfected security interest. *See* §§ 9-317(b) (tangible collateral) and (d) (intangible collateral). Section 9-317(d) addresses only accounts, electronic chattel paper, electronic documents, general intangibles, and investment property other than certificated securities. Because an unperfected security interest generally is enforceable against third parties, *see* § 9-203(b), buyers of other intangible collateral, such as commercial tort claims, take subject to an unperfected security interest. Members of the Review Committee who were active in the drafting of Article 9 think that this outcome is inadvertent.

E. Double debtors

Issue: Whether a financing statement filed against an original debtor in one jurisdiction should be effective for a limited period against the new debtor located in another jurisdiction with respect to collateral acquired by, or from a source other than, the original debtor.

Explanation: The public notice afforded by a financing statement filed against a debtor (the "original debtor") may become compromised when a "new debtor" succeeds to the original debtor's assets and liabilities. Consider, for example, the case where ABC Corp, an Illinois corporation, merges into XYZ Corp, a Massachusetts corporation. The financing statement filed against ABC in Illinois is seriously misleading with respect to the new debtor's name (XYZ) and is not filed in XYZ's location.

Despite the difference in names, the filed financing statement remains effective to perfect to perfect a security interest in property acquired by the new debtor before, and within four months after, the new debtor becomes bound as debtor by the original debtor's security agreement. *See* § 9-508(b). A security interest that is perfected by the filing against the original debtor in the original debtor's location generally remains effective for one year after the original debtor transfers the collateral to the new debtor. *See* § 9-316(a)(3). However, if the original debtor and new debtor are located in different jurisdictions, the financing statement filed in the original debtor's location is not effective to perfect a security interest in collateral that the new debtor acquires from a source other than the original debtor, whether before or after the merger.

Some have expressed concern that a secured party whose debtor (original debtor) merges out of existence enjoys no period of automatic perfection with respect to collateral acquired by the survivor (new debtor) from sources other than the original debtor, if the survivor is located in a different jurisdiction from the original debtor. A drafting committee might consider whether such a "grace period" is desirable and, if so, whether the creation of a grace period would require any corresponding changes to the rules governing priority between a security interest granted by the original debtor to one secured party and a security interest in the same collateral granted by the new debtor to a different secured party.

The new-debtor rules are analogous to those applicable to a single debtor who changes both its name and its location. Despite the difference in names, the filed financing statement remains effective to perfect a security interest in property acquired by the debtor before, and within four month after, the debtor changes its name. *See* § 9-507(c); *cf.* § 9-508(b). As regards collateral owned by the debtor before the relocation, a security interest that is perfected by the filing in the debtor's original location generally remains effective for four months after the debtor relocates to another jurisdiction. *See* § 9-316(a)(2); *cf.* § 9-316(a)(3).[2] However, a financing statement filed in the debtor's original location is not effective to perfect a security interest in collateral that the debtor acquires after it relocates. If a drafting committee thinks that a "grace period" is desirable in the setting of a new debtor, it may wish to consider whether a "grace period" is desirable in the debtor-relocation setting as well.

Providing "grace periods" in these contexts may reflect a policy change that would need to be justified.

F. Third party rights

Issue: Whether § 9-406(e) should be clarified as to whether, on an enforcement disposition by the secured party of a payment intangible or promissory note subject to a contractual anti-assignment term, the term is treated under § 9-406(d) (ineffective) or § 9-408(a) (effective if effective under other law).

Explanation: Sections 9-406(d) and 9-408(a) create a bifurcated approach for promissory notes and payment intangibles with respect to contractual anti-assignment terms. If a security interest in a promissory note or payment intangible secures an obligation, § 9-406(d) applies and fully overrides a contractual anti-assignment term. If the promissory note or payment intangible is sold, § 9-408(a) applies and only partially overrides a contractual anti-assignment term; the buyer's security interest may attach and be perfected but may not be enforced without the consent of the account debtor or the maker if the term is enforceable under other law.

However, § 9-406(e) states that § 9-406(d) does not apply to a sale of a payment intangible or promissory note. It is unclear whether § 9-406(e), when referring to a sale, refers only to a sale of payment intangible or promissory note that is itself a security interest and is therefore addressed in § 9-408(a) or whether the subsection is broader and includes a disposition by sale under § 9-610. Under the former interpretation, a contractual anti-assignment term would be overridden by § 9-406(d) on a disposition by sale; under the latter interpretation, it would not. The issue for a drafting committee is whether § 9-406(e) should be clarified and, if so, with what result.

The solution may implicate the need to clarify more generally a policy choice involving security interests in payment intangibles and promissory notes that contain contractual anti-assignment terms. If a security interest in a payment intangible or promissory note secures an obligation, § 9-406(d) permits a secured party to exercise its right of collection under § 9-607 against the account debtor or the maker notwithstanding an otherwise effective contractual anti-assignment term. However, if the security interest was the interest of a buyer of the payment intangible or promissory note, § 9-408(a) would not permit the secured party to exercise its right of collection in the face of an otherwise effective contractual anti-assignment term without the consent of the account debtor or the maker. The

[2] This period is shorter than the one-year period applicable to collateral transferred to a new debtor because a transfer of collateral may be more difficult to discover than a relocation of the debtor's chief executive office.)

difference in treatment of the contractual anti-assignment term with respect to the account debtor or the maker depending upon whether the security interest secures an obligation or is a sale would seem to suggest inconsistent policy choices between §§ 9-406(d) and 9-408(a) that may need to be addressed in connection with addressing any clarification of § 9-406(e).

Issue: If a drafting committee decides not to address § 9-406(e), or if it decides to clarify § 9-406(e) so that a contractual anti-assignment term is overridden on a sale by disposition under § 9-610, whether a payment intangible that is an interest in a partnership or limited liability company should be excluded from the operation of §§ 9-406(d) and 9-408(a).

Explanation: Concerns about the effect of §§ 9-406(d) and 9-408(a) on contractual anti-assignment terms relating to ownership interests in unincorporated business organizations, especially partnerships and limited liability companies, have caused Delaware, Kentucky, and Virginia to adopt non-uniform provisions excluding their application to those interests from §§ 9-406 and 9-408. The PEB is developing a Commentary that will address the issue, but, if the ambiguity in § 9-406(e) is not addressed or is addressed so that a contractual anti-assignment term is overridden on sale by disposition, it is possible that the Commentary will not be able to respond to the totality of the concerns raised. In that case, a drafting committee may wish to consider a uniform statutory solution to address the concerns.

G. Choice of law

Issue: Whether to clarify that § 9-307(c) has no application to a registered organization.

Explanation: Determining which jurisdiction's law governs perfection, the effect of perfection or non-perfection, or priority of a security interest under the choice-of-law rules in §§ 9-301 and 9-305(c) often requires a preliminary determination of where a debtor is "located." That location is determined by § 9-307. The rules in that section are complex, consisting of a three-part general rule in § 9-307(b) and a series of exceptions. The general rule is that a debtor who is an individual is located at his or her residence, and a debtor that is an organization is located at its place of business or chief executive office, as applicable.

Two important exceptions to the general rule are found in §§ 9-307(c) and 9-307(e). Section 9-307(c) provides that subsection (b) "applies only if [the law of the jurisdiction to which subsection (b) points] generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) does not apply, the debtor is located in the District of Columbia." Subsection (e) provides that "a registered organization that is organized under the law of a State is located in that State."

Consider the case of a debtor incorporated in Delaware but whose chief executive office is in a foreign jurisdiction whose law does not generally require filing as a condition of priority over a lien creditor. A fair reading of § 9-307(c) reflects the clear intent of the drafters: the debtor is located in Delaware by virtue of § 9-307(e). But it may be possible to read § 9-307(c) incorrectly as providing that the debtor is located in the District of Columbia. This is because the first sentence of that subsection provides that, in light of the law of the foreign jurisdiction, subsection (b) does not apply and the second sentence provides that "if subsection (b) does not apply, the debtor is located in the District of Columbia." This reading is possible because, unlike subsection (b), subsection (c) does not state that its rules are subject to rules appearing elsewhere in § 9-307.

A drafting committee might consider revising § 9-307 to avoid the incorrect reading or providing an expanded Official Comment to do so. The drafting committee might also consider clarifying that subsection (c) has no application to a debtor described in subsections (f), (i), and (j), or alternatively it might consider an expanded Official Comment to guide the reader to the same result.

H. <u>Enforcement</u>

<u>Issue</u>: Whether § 9-607(b) should permit a buyer of a payment right secured by a real estate mortgage to record an assignment of the mortgage upon the default of the account debtor or other person obligated on the collateral.

<u>Explanation</u>: A secured party may have a security interest in a payment right secured by a real estate mortgage. Section 9-607(b) permits the secured party, in connection with the non-judicial enforcement of the mortgage, to record documents in the real estate records to establish the secured party's right as assignee to enforce the mortgage. Prior to default, the secured party does not have the right to record. Section 9-607(b)'s reference to "default" appears to refer to the debtor's (mortgagee's) default on its obligations to the secured party. However, if the secured party is a buyer of the payment right, § 9-607(b) does not appear to permit the secured party to record the documents upon the default of the account debtor or any other person obligated on the collateral (mortgagor). The result is that the benefit of the subsection may not extend to buyers of payments rights when it likely should.

<u>Issue</u>: Whether it should be clarified that, even if the debtor agrees otherwise, a secured party may not acquire collateral at its own private disposition except in accordance with § 9-620.

<u>Explanation</u>: It is commonly understood that a debtor may not waive the application of the prohibition in § 9-610(c)(2), which generally prohibits a secured party from acquiring collateral at its own private disposition. However, a reference to § 9-610(c)(2) is not contained in § 9-602's list of provisions of Part 6 not capable of being waived by the debtor. The explanation for the omission is that a secured party's acquisition of collateral at its own private disposition is equivalent to an acceptance by the secured party of collateral in whole or, in a transaction that is not a consumer transaction, partial satisfaction of the secured obligations. *See* Official Comment 2 to § 9-624. Because the consent or acquiescence (failure to object) of the debtor is required for the acceptance and because the requirement of the debtor's consent or acquiescence may not under § 9-602(10) be waived by the debtor, the waiver issue under § 9-610(c)(2) appears to be addressed.

However, the question of whether § 9-610(c)(2) may be waived by the debtor continually arises in practice, and the explanation set forth above, which requires a reading of an Official Comment to an entirely different section of Article 9, may not be apparent to many practitioners.

<u>Issue</u>: Whether § 9-610(c)(2), which generally prohibits a secured party from acquiring collateral at its own private disposition, should also prohibit an affiliate of the secured party from doing so.

Explanation: Pursuant to § 9-610(c)(2), the secured party may purchase collateral at a public disposition, but may do so at a private disposition "only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations." It is clear that the rationale is that only in a private disposition of the sort described in the quoted language is the situation such that, like a public disposition, the private disposition will be at a market price or will it be obvious that the private sale was commercially reasonable. Although § 9-615(f) gives special scrutiny to a disposition not only to a secured party but also to "a person related to the secured party, or a secondary obligor," nothing in § 9-610(c)(2), prohibits an affiliate of the secured party from purchasing the collateral at a private disposition at which the secured party cannot purchase.[8] In light of the presence of the quoted language in § 9-615(f), juxtaposed with its absence in § 9-610(c)(2), it may be less likely that courts would read § 9-610(c)(2) as also covering "persons related to the secured party" that are not agents of the secured party. Yet, the dangers associated with a disposition to a person related to a secured party are no less in § 9-610(c)(2) than in § 9-615(f).

A drafting committee might consider revising § 9-610(c)(2) to prohibit private dispositions to persons related to the secured party to the same extent as they are prohibited to the secured party itself. In doing so, the drafting committee might consider whether such a revision would reflect a policy change that would need to be justified.

Issue: Whether the caption to § 9-625(c) referring to consumer-goods transactions should be changed to refer to consumer goods to conform to the text of § 9-625(c)(2).

Explanation: The text of § 9-625(c)(2) covers consumer goods even if the transaction itself is not a consumer-goods transaction. However, the caption suggests that the text applies only if the security interest arises in a "consumer-goods transaction". For example, a security interest in the debtor's personal automobile (a consumer good) that secures a loan to the debtor's business would not fall within the definition of "consumer-goods transaction" in § 9-102(a)(24) because the transaction is not primarily for the debtor's personal, family or household purposes. Although the caption indicates that § 9-625(c) does not cover such a security interest, the text does cover it.

Issue: Whether the reference in § 9-627(a) to "acceptance" should be deleted.

Explanation: Section 9-627 provides that the fact that a higher price might have been obtained from the enforcement of a security interest is not of itself sufficient to preclude the secured party from showing that "the collection, enforcement, disposition, or acceptance [of the collateral] was made in a commercially reasonable manner". The reference to "acceptance" is inappropriate, because an "acceptance" of collateral under § 9-620 is not subject to a commercial reasonableness test.

I. Other

Issue: Whether Article 11 should be repealed as no longer relevant.

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[8] If the affiliate is an agent of the secured party, its action might be deemed to be that of the secured party under agency principles incorporated by § 1-103(b), but an affiliate of a secured party will not always be its agent.

Explanation: When the Uniform Commercial Code was originally promulgated, it included a separate Article – Article 10 – that provided, *inter alia*, for its effective date and transition rules for transactions entered into before the effective date. When Article 9 was revised in 1972, it was similarly accompanied by an Article – Article 11 – containing provisions for the effective date of the revisions as well as transition rules for transactions entered into before the effective date of the revisions.[9] It is now 36 years since the promulgation of the 1972 amendments and over a quarter-century since their widespread enactment. As such, it is quite unlikely that there are more than a trivial number of outstanding transactions (if any) that were entered into before the effective date of the 1972 amendments and for which transition rules to the 1972 text of Article 9 (now supplanted by revised Article 9) remain relevant.

Official Comments Modification Issues List

In its review of issues that might be addressed by a drafting committee for statutory modifications to the Official Text of Article 9, the Review Committee considered other issues that it thought would be more appropriately addressed, if at all, by changes to the Official Comments. Those issues are set forth below. The list is not intended to exhaustive of other modifications to the Official Comments that might be desirable based on the considerations of a drafting committee and which presumably would be within prerogative of the drafting committee's reporter based on the guidance of the drafting committee.

Issue: Whether an Official Comment should indicate by illustration what is sufficient for an e-mail to be "authenticated."

Explanation: Several provisions in Article 9 require that a record be "authenticated." Many have noted that the definition of "authenticate" in § 9-102(a)(7)(B) does not provide clear guidance as to whether an e-mail is authenticated. Consider three situations in which a person composes and sends and e-mail. In the first situation, the person types the text of the message and also types his or her name at the end of the message, and then enters the command to send the message to the recipient. In the second situation, the person types the text of the message, but does not type his or her name at the end of the message, and enters the command to send the message to the recipient. In the third situation, the person types the text of the message and does not type his or her name at the end of the message; when the sender enters the command to send the message to the recipient, however, the sender's name is automatically added to the bottom of the message as a result of an option previously selected by the sender in configuring his or her e-mail system. It seems clear that the first situation describes an authenticated e-mail. It is less clear, though, whether the second and third situations fulfill the requirements for authentication.[10]

Issue: Whether the *Enron* debt trading case, distinguishing between a "sale" and an "assignment" of a loan, should be addressed in the Official Comments.

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[9] Article 11 is preceded by the following legend: "This draft was prepared by the Reporters and has not been passed upon by the Review Committee, the Permanent Editorial Board, the American Law Institute, or the National Conference of Commissioners on Uniform State Laws. It is submitted as a working draft which may be adapted as appropriate in each state. The 'Discussions' [the comments following each section] were written by the Reporters to assist in understanding the purpose of the drafts." The legend suggests that, as a technical matter, Article 11 might not be part of the "Official Text" of the UCC. Nonetheless, it is generally treated as such and, for purposes of this report, the Review Committee has treated it as such.

[10] It does not appear that conforming the definition of "authenticate" to parallel definitions in Articles 2, 2A, and 7, the subject of the recommendation in Part IV.A, *supra*, will resolve this issue.

Explanation: In connection with claims trading the question sometimes arises as to whether the obligor on a debt may assert claims and defenses against the transferee of the claim. Traditionally this issue has been analyzed by considering whether the transferee qualifies as a holder in due course (in the case of a claim embodied in a negotiable instrument) or other good faith purchaser for value (in the case of other claims), in which case the obligor generally may not assert claims and defenses against the transferee. In addressing this issue with respect to the bankruptcy rights of a transferee, the court in *Enron Corp. v. Springfield Assocs., L.L.C. (In re Enron Corp.)*, 379 B.R. 425 (Bankr. S.D.N.Y. 2007), by interpreting several cases under state law, has articulated a distinction between "assignments" and "sales." According to the court, a claim of a transferee who takes by sale is not subject to equitable subordination or disallowance under the Bankruptcy Code, while a claim that is taken by assignment is subject to these disabilities. No such distinction appears in the Uniform Commercial Code. The Official Comments might confirm that, when the term "assignment" is used in the Uniform Commercial Code, the term includes a sale and is not distinct from a sale. *Cf.* Official Comment 26 to § 9-102.

Issue: Whether an Official Comment to § 9-104 should clarify that § 8-106(d)(3) reflects a principle of agency law that is also applicable to § 9-104.

Explanation: Section 8-103(d)(3) provides that a purchaser may achieve control of a security entitlement if another person has control on behalf of the purchaser or, if the person already has control, acknowledges that it has control on behalf of the purchaser. No similar provision is contained in § 9-104 addressing control of a deposit account However, under § 1-103, the law of principal and agent applies to the Uniform Commercial Code unless displaced by a particular provision. An Official Comment might be provided to § 9-104 to overcome any negative inference regarding the ability of an agent to have control for its principal under § 9-104.

Issue: Whether an Official Comment should address the role, if any, of the parties' intent in interpreting § 9-109(a)(1).

Explanation: Section 9-109(a)(1) restates the traditional rule that Article 9's rules apply to a transaction "regardless of its form" if it creates what amounts to a security interest in personal property. Thus, courts have felt free to recharacterize sales as secured transactions when the economic effects of the transaction made that appropriate. It is inherent in that rule that the parties cannot control application of the statute by mere pronouncement that a transaction is not (or is) intended to create a security interest. Nevertheless, some courts have continued to look to the intent of the parties, as reflected in the transaction documents, to determine whether to characterize the transaction as a security interest.

Issue: Whether an Official Comment might clarify that § 9-307(c) should apply to the specific collateral in question in contrast to collateral generally.

Explanation: As mentioned above,[11] § 9-307(b) provides the general rules for determining where a given debtor is located for purposes of the choice-of-law rules in Article 9. Under § 9-307(b), a non-US debtor normally would be located in a foreign jurisdiction

[11] Part IV.G, *supra*.

and foreign law would govern perfection. If foreign law affords no public notice of security interests, the general rules yield unacceptable results. Accordingly, § 9-307(c) provides that the general rules for determining the location of a debtor apply only if they yield a location that is "a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral." If the location lacks such a public-notice system for the collateral in question, then the general rules in § 9-307(b) do not apply, the debtor is located in the District of Columbia, and the law of the District of Columbia governs perfection. Some have read § 9-307(c) to refer to collateral generally rather to the particular collateral at issue. The latter reading would require a broader and more difficult inquiry than § 9-307(c) requires.

Issue: Whether an Official Comment should clarify how the priority rules apply to a security interest that, under § 9-309(3) or (4), is perfected upon attachment and without filing, but as to which a financing statement nevertheless has been filed.

Explanation: The "first-to-file-or-perfect" rule of § 9-322(a) governs the priority of conflicting security interests arising from successive sales of a payment intangible or promissory note. A security interest that arises upon the sale of payment intangibles or promissory notes is "automatically" perfected under § 9-309(3) or (4). There is a question whether, by filing a financing statement covering a payment intangible or promissory note that may be sold in the future, a buyer may establish priority based on the time of filing rather than on the later time when the security interest becomes automatically perfected (i.e., when the security interest attaches, which normally is the time of the sale).

If a drafting committee decides to address this issue in an Official Comment, it may wish to consider whether to address other security interests for which § 9-309 provides automatic perfection. In this regard, the drafting committee may wish to take into account §§ 9-320(b) and 9-324(g). Under the former section, the resolution of a priority contest between a buyer of consumer goods and the holder of a perfected purchase-money security interest in those goods turns on whether a financing statement has been filed with respect to the purchase-money security interest, even if the purchase-money security interest is automatically perfected under § 9-309(1). The latter section provides that, in some cases, § 9-322(a) resolves the priority of conflicting purchase-money security interests in consumer goods.

Issue: Whether an Official Comment to § 9-316(d) should make clear that § 9-316(d) does not apply in cases where perfection is accomplished in one state by a method other than compliance with that state's certificate-of-title law, the debtor relocates to a state whose certificate-of-title law governs perfection, and then the goods become covered by a certificate in the new state.

Explanation: § 9-316(d) is not ambiguous, but its application when a secured party is perfected in one state by a method other than notation of its security interest on the certificate-of-title and the goods then become covered by a certificate of title issued by another state is complex and might be clarified by an Official Comment. More specifically, there is some concern that the distinction between § 9-316(a) and § 9-316(d) might not be obvious. For example, assume that perfection of a security interest in a boat in State A is not governed by a certificate-of-title statute in State A whereas the opposite is true in State B. If a secured party's security interest in the boat is perfected by filing (or otherwise, as by automatic perfection in the case of a purchase-money security interest in consumer goods) in State A and the debtor relocates to State B, § 9-316(a) applies and § 9-316(d) does not. The reason subsection (d) does not apply is that as soon as the debtor relocates, the law of State B governs perfection under § 9-301(1) and the requirement of subsection (d) that the goods "be perfected by the law of another jurisdiction when the goods become covered by a certificate of title" issued by State B cannot be satisfied. An explanatory Official Comment might note that subsection (d) applies only when the debtor remains in the jurisdiction where non-certificate-of-title perfection was accomplished and the goods become covered by a certificate of title issued by another jurisdiction.

Issue: Whether an Official Comment should clarify that, when a debtor converts from one entity to another entity (e.g., a partnership converts to a limited liability company) and the applicable state entity conversion statute provides that the converted entity is the "same" entity as the converting entity, Article 9 follows the applicable state law and treats the converting entity and the converted entity as the same entity.

Explanation: Article 9 has several rules that address the transfer of collateral or the change in location of the debtor. When the debtor transfers collateral to another person, that person becomes the debtor. If the transferee debtor is located in a different state than the transferor, then the secured party of the transferor has one year to file a financing statement (or otherwise to perfect) against the transferee if the secured party wants to maintain continuous priority. Section 9-316(a)(3). If the debtor retains the collateral, but changes its (the debtor's) location, then as to existing collateral the secured party of the debtor has four months to file a financing statement in the debtor's new location (or otherwise to perfect the security interest). Section 9-316(a)(2). Some entity statutes provide that, if an entity in one state converts to become an entity formed under the law of another state, the surviving entity is the "same" entity as the disappearing entity. Because Article 9 follows other law in this regard, the Article 9 rules applicable to the change in location of the debtor, rather than the rules that would apply to a transfer of collateral, govern perfection issues.[12]

Issue: Whether, in a priority dispute between SP1 and SP2 as to the post-merger accounts in the following fact pattern, an Official Comment should clarify that the dispute is resolved under § 9-326, not § 9-322(a).

> ABC and XYZ are registered organizations located in the same state. SP1 has a filed perfected security interest in existing and after-acquired accounts of ABC. SP2 has a filed perfected security interest in existing and after-acquired accounts of XYZ. ABC merges into XYZ. SP1 files against XYZ during § 9-508(b)'s four-month grace period.

Explanation: In this fact pattern, XYZ is a "new debtor" from SP1's perspective, and so SP1's security interest attaches to accounts acquired by XYZ after the merger. *See* § 9-203(d), (e). Even if SP1 takes no action, the financing statement that SP1 filed against ABC is effective to perfect a security interest in accounts that XYZ acquires during the four-month period following the merger. *See* §§ 9-509(a) and (b). SP2's security interest also attaches to accounts acquired by its debtor, XYZ, after the merger. Section 9-326(a) operates to

[12] A drafting committee might survey applicable state statutes that view converting entities as the same entities as the converted entities in order to determine whether the suggested approach of following law other than Article 9 might lead to any undesirable outcomes on priority issues.

subordinate SP1's security interest to SP2's with respect to "collateral in which a new debtor has or acquires rights," but only if SP1's security interest is "perfected by a filed financing statement that is effective solely under Section 9-508." Without § 9-508, SP1's financing statement would have no effect with respect to the accounts acquired by XYZ after the merger. Accordingly, SP1's financing statement would be "effective solely under Section 9-508" with respect to that collateral, and § 9-326(a) would subordinate SP1's security interest in that collateral to SP2's.

Note, however, that even without § 9-508, SP1's financing statement would be effective against other collateral owned by XYZ, specifically, any accounts acquired from ABC as part of the merger. *See* §§ 9-507(a) and 9-508(c). An Official Comment might provide guidance to the effect that one must look only at the collateral in question when determining whether a financing statement "is effective solely under Section 9-508."

Issue: Whether an Official Comment should explain that a fixture filing for a debtor that is a transmitting utility must be made in the central filing office in each state in which the fixtures are located rather than in the central filing office in the state in which the debtor is located.

Explanation: Section 9-501(b) permits a financing statement for which the debtor is a transmitting utility to be filed in the central filing office of the state. Under § 9-301(1), as a general matter, the financing statement would be filed in the state in which the transmitting utility debtor is located. Section 9-501(b) goes on, though, to provide in a second sentence that a fixture filing against a transmitting utility debtor may also be filed in the central filing office. Some have read this sentence to suggest that the fixture filing should be made in the central filing office of the state in which the transmitting utility debtor is located. However, because under § 9-301(3)(A) the perfection of a security interest in fixtures is governed by the law of the state in which the fixtures are located, the better reading of the sentence, when considered together with § 9-301(3)(A), is that a transmitting utility debtor fixture filing must be made in the central filing office of each state in which the fixtures are located, not as a single fixture filing in central filing office of the state in the which the debtor is located.

Issue: Whether an Official Comment to § 9-509 should explain the circumstances in which an assignee of a security interest may be impliedly authorized by the assignor to file an assignment to the assignee of the assignor's filed financing statement covering the collateral.

Explanation: Section 9-509(d)(1) provides that, in the case of an assignment of a security interest, the "secured party of record" must authorize the filing of any amendment to the financing statement that shows the new holder of the security interest as the successor secured party of record. In some transactions involving the sale of an obligation secured by a security interest, the parties may not think to include an express authorization for the transferee of the security interest to file an amendment to the financing statement to show the transferee as the successor secured party of record. Article 9 does not require that the "authorization" be in an authenticated record, and it would seem that the authorization would often be implied as part of the transfer itself.

Issue: Whether the last two sentences of Official Comment 3 to § 9-509, providing for later ratification by the debtor of the filing of a financing statement by the secured party without the debtor's authorization in an authenticated record, should be modified to refer to the Restatement 3d of Agency's provisions addressing the ratification by a principal of the prior acts of its agent.

Explanation: Section 9-510 provides that a filed record (e.g., a financing statement) is effective only to the extent that it was filed by a person that may file it under § 9-509. Section 9-509 generally provides that a person may file an initial financing statement only if the debtor authorizes the filing in an authenticated record. The section specifically provides that, by authenticating a security agreement, a debtor authorizes the filing of an initial financing statement covering the collateral described in the security agreement. Secured parties often file an initial financing statement while the details of a financing are being negotiated and before the debtor authenticates a security agreement. If the debtor has not authorized the filing of such a financing statement in an authenticated record, then the financing statement is ineffective. However, the debtor's subsequent authentication of the security agreement would ratify the filing and make the financing statement effective. *See* Official Comment 3 to § 9-509 (explaining that law other than Article 9, "including the law with respect to ratification of past acts, generally determines whether a person has the requisite authority to file a record" under § 9-509).

Some have questioned whether, for purposes of the first-to-file-or-perfect rule in § 9-322(a), the priority of a financing statement whose filing has been ratified should date from the date of filing or from the date of ratification. Inasmuch as the public notice afforded by an unratified financing statement is equal to that of a financing statement whose filing was authorized *ab initio*, there is no reason not to date the priority of a ratified filing from the date of filing. Although Restatement (3d) of Agency § 4.02 might be read to suggest otherwise, Comment *e* to that section explains that "If other law provides rules for priority of rights, that other law governs. See, e.g., U.C.C. §§ 9–322 and 9–509 and Comment 3 to § 9–509 (last sentence)." The last two sentences of Official Comment 3 to § 9-509 might be modified to refer to Comment *e* to § 4.02 of the Restatement (3d) of Agency.

Issue: Whether the Official Comments to §§ 9-613 and 9-614 should explain how a notification of an internet disposition may comply with those sections.

Explanation: Sections 9-613 and 9-614 provide that a notification of a disposition of collateral must provide the time and place of a public disposition or the time after which any other disposition is to be made. Each section also provides a safe-harbor form of notification that, when properly completed, is sufficient to comply with the requirements of the section. The use of on-line auctions for the disposition of collateral has become widespread. Secured parties have found that the internet expands the marketplace for repossessed goods and other collateral and that it is an efficient marketplace that benefits both secured party and debtor. However, neither §§ 9-613 and 9-614, nor the Official Comments, give guidance to secured parties on how to comply with the notification requirements, or use the safe harbor forms, when disposing of collateral through on-line sales and auctions.

Issue: Whether it should be clarified by an Official Comment to § 9-706 that § 9-506(c) applies to an "in lieu" initial financing statement.

Explanation: During the transition period following the enactment of revised Article 9, and today under more limited circumstances, secured parties file "in-lieu" initial financing statements in a new filing office to move filing office records evidencing perfection by filing of a security interest from one jurisdiction to another as required by the choice-of-law and filing rules of Article 9. In addition to the information required by Part 5 of Article 9 for an initial financing statement, the "in-lieu" initial financing statement must contain the information required by §§ 9-706(c)(2) and (3). The additional information relates to the financing statement filed in the original filing office and dates the priority of the secured party's security interest from a date established by the original filing. However, if there is a minor error in the additional information required by § 9-706, a court could find the error not to be covered by the minor errors rule of § 9-506 because of a reference in § 9-506 to "the requirements of this part...." The reference to "this part" of Article 9 is to Part 5 of Article 9, suggesting that the provision has no application to the transition rules in Part 7.

JOINT REVIEW COMMITTEE ON
UNIFORM COMMERCIAL CODE ARTICLE 9

TENTATIVE AGENDA

October 3-5, 2008
Chicago

Edwin E. Smith, Chair
Steven L. Harris, Reporter

[An asterisk (*) indicates materials that are being distributed with this Agenda.]
[references to "IL" are to the Article Review Committee's Issues List]

Note: The discussion of Item XIII (filing) will begin on Saturday morning, October 4, 2008.

I. Introductory remarks from the Chair (Smith).

II. Enforcement (IL § IV.H).

A. Right to record assignment of mortgage upon mortgagor's default.

B. Strict foreclosure as the only way to "waive" the prohibition on private sale to secured party.

C. Prohibition on private disposition to transferees who are persons related to secured party.

D. Conform heading of § 9-625(c) to text.

E. Delete reference to "acceptance" in § 9-627(a).

III. Repeal of Article 11 (IL § IV.I).

IV. Payoff letter (IL § IV.B).

V. Expansion of § 9-317(d) (IL § IV.D).

VI. Conforming Article 9 to other uniform texts.

A. Definition of "authenticate" (IL § IV.A).

<u>Materials</u>: UCC § 7-102(a)(11).

B. Definition of "certificate of title" (IL § IV.A).

Materials: UCOTA §§ 2(a)(27), 25, 26.

C. Definition of "control" (IL §§ IV.A; III.A).

Materials: UCC § 7-106; Delaware nonuniform §§ 9-104; 9-106; 8-106

VII. Definition of "security" (*Highland Capital*) (IL § II.B).

VIII. Double-debtor issues (IL § IV.E).

IX. Effect of anti-assignment clauses (IL § IV.F).

Materials: Statement of the § 9-406(3) issue and position papers from Messrs. Cohen, Henning, Smith and Weise.

X. Effect of filing with respect to sales of payment intangibles (IL p. 17).

Materials: Memorandum from Kenneth C. Kettering (Aug. 6, 2008).

XI. Classification of "stripped" rentals (Commercial Money Center) (IL § II.A).

Materials: Letter from the UCC Committee of the California State Bar (Nov. 5, 2006).

XII. Treatment of consumer-goods related intangibles (IL § IV.C).

XIII. Filing (discussion of filing issues to begin on Saturday morning, October 4, 2008).

Materials: International Association of Commercial Administrators Proposed Statutory Changes (Dec. 11, 2007).

Memorandum from the UCC Committee of the California State Bar (May 1, 2008).

A. Transmitting utilities (IL § I.B).

B. Name of registered organization; definition of "registered organizations" (IL §§ I.A.2; IV.A).

C. Name of business-trust debtor (IL § I.A.3).

D. Application of § 9-307(c) to registered organizations (IL § IV.G)..

E. Location of registered organization organized under federal law (IL § III.B).

<u>Materials</u>: Delaware nonuniform § 9-307.

Memorandum from Kenneth C. Kettering (Aug. 6, 2008).

F. Name of individual debtor (IL § I.A.1.).

<u>Materials</u>: Memorandum from the UCC Committee of the California State Bar (May 4, 2008).

Nebraska, Tennessee, and Texas nonuniform amendments.

G. Correction statements (IL § I.D.).

H. Official forms (IL § I.C.).

XIV. Agenda for next meeting.

XV. Adjournment (by 12:00 noon, October 5, 2008).

SECTION 7-102. DEFINITIONS AND INDEX OF DEFINITIONS.

(a) In this article, unless the context otherwise requires:

(11) "Sign" means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach to or logically associate with the record an electronic sound, symbol, or process.

For purposes of this subsection, a person may "authenticate" a record by (i) signing a record that is a writing or (ii) attaching to or logically associating with a record that is not a writing an electronic sound, symbol or process with the present intent to adopt or accept the record. See Sections 1-201(b)(37) and 9-102(a)(7).

UNIFORM CERTIFICATE OF TITLE ACT

SECTION 2. DEFINITIONS.

(a) In this [act]:

(27) "Security-interest statement" means:

(A) a record created by a secured party which indicates a security interest; or

(B) an application for which the office is required to create a certificate of title, if the application indicates a security interest.

SECTION 25. EFFECTIVENESS OF SECURITY-INTEREST STATEMENT.

(a) A security-interest statement is sufficient if it includes the name of the debtor, the name of the secured party or a representative of the secured party, a description that reasonably identifies the vehicle and is not seriously misleading under Section 20, and is delivered as follows:

(A) if the security-interest statement is indicated on an application for which the office is required to create a certificate of title, by the owner; or

(B) if the security-interest statement is not indicated on an application for which the office is required to create a certificate of title, by a person authorized to file an initial financing statement covering the vehicle pursuant to [Uniform Commercial Code Section 9-509].

(b) A security-interest statement that is sufficient under subsection (a) is effective upon receipt by the office.

(c) Subject to subsections (e) and (f), a security-interest statement is not received if the office rejects the statement pursuant to subsection (e). The office may reject a security-interest statement only in the manner specified in subsection (e) and only if:

(1) the record is not delivered by a means authorized by the office;

(2) an amount equal to or greater than the required filing fee is not tendered with the statement or, if the office elects to notify the secured party of the filing fee deficiency, within seven days after the notification has been given;

(3) the record does not include the name and mailing address of a debtor and a secured party or a representative of a secured party;

(4) the record does not contain the vehicle identification number; or

(5) the office cannot identify a file of the office, certificate of title, or application for a certificate of title to which the security-interest statement relates.

(d) The office shall maintain files of the office showing the date of receipt of each security-interest statement that is not rejected and shall make this information available on request.

(e) To reject a security-interest statement, the office must send notice of rejection to the person that delivered the statement, indicating the reasons for the rejection and the date the statement would have been received had the office not rejected it.

(f) If the office does not send notice of rejection under subsection (e), the security-interest statement is received as of the time it was delivered to the office. Confirmation by the office that the security-interest statement has been entered in the files of the office is conclusive proof that receipt has occurred.

(g) If a security-interest statement sufficient under subsection (a) is tendered with the filing fee and the office sends a notice of rejection without indicating a reason set forth in subsection (c), the security-interest statement is effective as of the business day on which the statement was tendered to the office except as against a purchaser of the vehicle which gives value in reasonable reliance upon the absence of the security-interest statement from the files of the office.

(h) Failure of the office to index a security-interest statement correctly or to indicate the security interest on the certificate of title does not affect the receipt of the security-interest statement.

SECTION 26. PERFECTION OF SECURITY INTEREST.

(a) Except as otherwise provided in subsection (b), (d), or (e), a security interest in a vehicle may be perfected only by a security-interest statement that is effective under Section 25. The security interest is perfected upon the later of receipt of the security-interest statement under Section 25 or attachment of the security interest under [Uniform Commercial Code Section 9-203].

(b) If the office creates a certificate of title naming a lessor, consignor, bailor, or secured party as owner and the interest of the person named as owner is a security interest, the certificate of title serves as a security-interest statement that provides the name of the person as secured party. If the interest of the person named as owner in an application for a certificate of title delivered to the office in accordance with Section 9 is a security interest, the application is a security-interest statement that provides the name of the person as secured party. The naming of the person as owner on the application or certificate of title is not of itself a factor in determining whether the interest is a security interest.

(c) If a secured party assigns a perfected security interest in a vehicle, the receipt by the office of a security-interest statement providing the name of the transferee or its representative as secured party is not required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor. However, a purchaser of a vehicle subject to a security interest which obtains a release from the secured party indicated in the files of the office or on the certificate of title takes free of the security interest and of the rights of a transferee if the transfer is not indicated in the files of the office and on the certificate of title.

(d) This section does not apply to a security interest in a vehicle created by a person during any period in which the vehicle is inventory held for sale or lease by the person or is leased by the person as lessor if the person is in the business of selling goods of that kind.

(e) A security interest is perfected to the extent provided in [Uniform Commercial Code Section 9-316(d)]. A secured party may also perfect a security interest by taking possession of a vehicle only pursuant to [Uniform Commercial Code Sections 9-313(b) and 9-316(d)].

SECTION 7-106. CONTROL OF ELECTRONIC DOCUMENT OF TITLE.

(a) A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

(b) A system satisfies subsection (a), and a person is deemed to have control of an electronic document of title, if the document is created, stored, and assigned in such a manner that:

(1) a single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

(2) the authoritative copy identifies the person asserting control as:

(A) the person to which the document was issued; or

(B) if the authoritative copy indicates that the document has been transferred, the person to which the document was most recently transferred;

(3) the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(4) copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

DELAWARE VERSION

§ 9-104. Control of deposit account.

(a) Requirements for control. -- A secured party has control of a deposit account if:

(1) the secured party is the bank with which the deposit account is maintained;

(2) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the account without further consent by the debtor;

(3) the secured party becomes the bank's customer with respect to the deposit account;

(4) the debtor, secured party, and bank have authenticated a record that (i) is conspicuously denominated a control agreement, (ii) identifies the specific deposit account in which the secured party claims a security interest, and (iii) contains one or more provisions addressing the disposition of funds in the deposit account or the right to direct the disposition of funds in the deposit account; or

(5) the name on the deposit account is the name of the secured party or indicates that the secured party has a security interest in the deposit account.

(b) Debtor's right to direct disposition. -- A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

(c) No implied duties of bank. -- The authentication of a record by the bank under subsection (a)(2) or (a)(4) does not impose upon the bank any duty not expressly agreed to by the bank in the record. The naming of the deposit account in the name of the secured party or with an indication that the secured party has a security interest in the deposit account under subsection (a)(5) does not impose upon the bank any duty not expressly agreed to by the bank.

(d) Conditions not relevant. -- A secured party has control under subsection (a)(2) even if any duty of the bank to comply with instructions originated by the secured party directing disposition of the funds in the deposit account is subject to any condition or conditions (other than further consent by the debtor). A secured party has control under subsection (a)(4) even if the provision or provisions addressing the disposition of funds in the deposit account or the right to direct the disposition of funds in the deposit account are subject to any condition or conditions (other than further consent by the debtor).

(e) No inferences. -- The procedures and requirements of subsections (a)(4) and (a)(5) available to obtain control shall not be used in interpreting the sufficiency of a secured party's compliance with the procedures and requirements of subsections (a)(1), (a)(2) or (a)(3) to obtain control. The provisions of subsections (a)(4) and (a)(5) shall create no inference regarding the requirements for compliance with subsection (a)(1), (a)(2) or (a)(3). (72 Del. Laws, c. 401, § 1; 76 Del. Laws, c. 92, §§ 1, 2.)

DELAWARE VERSION

§ 9-106. Control of investment property.

(a) Control under Section 8-106. -- A person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 8-106.

(b) Control of commodity contract. -- A secured party has control of a commodity contract if:

(1) the secured party is the commodity intermediary with which the commodity contract is carried; or

(2) the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) Effect of control of securities account or commodity account. -- A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

(d) Control of securities account. -- A secured party has control of a securities account if the name on the securities account is the name of the secured party or indicates that the secured party has a security interest in the securities account.

(e) No implied duties of securities intermediary. -- The naming of the securities account in the name of the secured party or with an indication that the secured party has a security interest in the securities account under subsection (d) does not impose upon the securities intermediary any duty not expressly agreed to by the securities intermediary. (72 Del. Laws, c. 401, § 1; 76 Del. Laws, c. 92, § 3.)

DELAWARE VERSION

§ 8-106. Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) the certificate is endorsed to the purchaser or in blank by an effective endorsement; or

(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser;

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner; or

(3) the issuer, the registered owner, and the purchaser have authenticated a record that (i) is conspicuously denominated a control agreement, (ii) identifies the uncertificated security in which the purchaser claims an interest, and (iii) contains 1 or more provisions addressing instructions relating to the uncertificated security or the right to originate instructions relating to the uncertificated security.

(d) A purchaser has "control" of a security entitlement if:

(1) the purchaser becomes the entitlement holder;

(2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder;

(3) another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser; or

(4) the securities intermediary, the entitlement holder, and the purchaser have authenticated a record that (i) is conspicuously denominated a control agreement, (ii) identifies the security entitlement in which the purchaser claims an interest, and (iii) contains one or more provisions addressing entitlement orders relating to the security

entitlement or the right to originate entitlement orders relating to the security entitlement.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) has control, even if the registered owner in the case of subsection (c) or the entitlement holder in the case of subsection (d) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c)(2), (c)(3), (d)(2), or (d)(4) without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

(h) Under subsection (c)(2), (c)(3), (d)(2), or (d)(4), authentication of a record does not impose upon the issuer or securities intermediary any duty not expressly agreed to by the issuer or securities intermediary in the record.

(i) A purchaser has "control" under subsection (c)(2), (c)(3), (d)(2), or (d)(4) even if any duty of the issuer or the securities intermediary to comply with instructions or entitlement orders originated by the purchaser is subject to any condition or conditions (other than further consent by the registered owner or the entitlement holder). (71 Del. Laws, c. 75, §1; 72 Del. Laws, c. 401, §§ 19, 20; 76 Del. Laws, c. 92, §§ 4-7).

Issue:

Is the effect of a contractual restriction on transfer that applies to a payment intangible or a promissory note determined by UCC section 9-406(d), by sections 9-408(a) and 9-408(d), or by other law in a case in which (i) the obligee of the payment intangible or promissory note grants a security interest in the payment intangible or the promissory note to secure an obligation, (ii) the obligee defaults with respect to the security interest, and (iii) the secured party wishes to enforce the security interest by disposing of the payment intangible or promissory note through sale pursuant to section 9-610?

Background:

Article 9 of the Uniform Commercial Code includes within its scope two types of transactions with respect to payment intangibles and promissory notes. First, pursuant to section 9-109(a)(1), Article 9 governs consensual transactions in which a payment intangible or promissory note is collateral for an obligation. Second, pursuant to section 9-109(a)(3), Article 9 governs consensual sales of payment intangibles and promissory notes. The right of the secured creditor in the first type of transaction and the right of the buyer in the second type of transaction are both defined in UCC Article 1 as a "security interest." See section 1-201(b)(35).

Frequently, payment intangibles are the subject of an agreement between the obligor (referred to in Article 9 as the "account debtor") and the obligee that, by its terms, would limit the ability of the obligee to assign the payment intangible. Similarly, promissory notes (other than those that fulfill the criteria of negotiable instruments) frequently contain such restrictions. (Contractual restrictions that would limit the ability of the obligee to assign a payment intangible or promissory note are hereinafter referred to as "transfer restrictions.") The effect of transfer restrictions is limited by Article 9.

Two similar, but not overlapping, provisions in Article 9 – sections 9-406(d) and 9-408(a) – override or limit the effect of certain transfer restrictions in payment intangibles and promissory notes. Because the two provisions sometimes work in different ways, and sometimes have different effects on the transfer restrictions within their scope, it is important to determine which provision applies to which situation. The two provisions work as follows:

- Section 9-406(d) provides that transfer restrictions are ineffective to the extent that they limit "the assignment or transfer of, or the creation, attachment, perfection, or *enforcement* of a security interest in, the … payment intangible or promissory note." (emphasis added)

- Section 9-408(a) provides that transfer restrictions are ineffective to the extent that they limit "the assignment or transfer of, or creation, attachment or perfection of a security interest in, the promissory note … or general intangible." Unlike UCC section 9-406(d), section 9-408(a) does

> not override restrictions with respect to the "enforcement" of a security interest. Moreover, the limited effect of UCC section 9-408(a) is confirmed by section 9-408(d), which further describes the effect of subsection (a) on the account debtor on a payment intangible or obligor on a promissory note.

Section 9-408(a) does not apply to a payment intangible or promissory note if section 9-406(d) is applicable. This is made clear by section 9-408(b), which provides that section 9-408(a) "applies to a security interest in a payment intangible or promissory note *only if* the security interest arises out of a sale of the payment intangible or promissory note" (emphasis added) and by section 9-406(e), which provides that "Subsection (d) [of section 9-406] does not apply to the sale of a payment intangible or promissory note."

Since sections 9-406(d) and 9-408(a) apply to different transactions and do not overlap in their coverage, only one of the two provisions, or other law, can apply to the issue described above – the post-default disposition via sale of a payment intangible or promissory note that is collateral for an obligation.

In analyzing whether section 9-406(d), section 9-408(a), or other law applies to the issue raised above, section 9-406(e) is a key provision. If section 9-406(e) prevents application of section 9-406(d), then, depending on the circumstances, either section 9-408(a) or other law will apply. Otherwise, UCC section 9-406(d) will apply.

In the issue raised above, it can be argued that, because the security interest that is sought to be enforced is not one that arose from a sale of the payment intangible or promissory note but, rather, is a security interest in that property that secures an obligation, section 9-406(e) is inapplicable to the disposition via sale under section 9-610 and, accordingly, section 9-406(d) determines the effect of the transfer restriction. In that case, because section 9-406(d) overrides transfer restrictions to the extent that they limit enforcement of a security interest, the transfer restriction would be ineffective to the extent that it would interfere with enforcement of the security interest by a disposition via sale under section 9-610. Accordingly, the transfer restriction would not preclude disposition by sale and the buyer at the disposition sale would be able to enforce the payment intangible or promissory note against the account debtor or obligor.

On the other hand, it can be argued that section 9-406(e) applies to a disposition via sale of a payment intangible or promissory even if the original security interest was not itself created by a sale but rather was an interest in the payment intangible or promissory note as collateral for an obligation. In that case, section 9-406(d) would not be applicable and either section 9-408(a) and section 9-408(d) would apply, thereby allowing the disposition sale but limiting the buyer's ability to enforce the payment intangible or promissory note against the account debtor or obligor, or other law would determine the fate of the transfer restriction.

PERMANENT EDITORIAL BOARD OF THE UNIFORM COMMERCIAL CODE

POSITION PAPER ON SECTION 9-406(e)

SECTION 9-406(e) APPLIES TO DISPOSITIONS OF PAYMENT INTANGIBLES AND PROMISSORY NOTES

February 2008

Section 9-406(e) applies to a disposition of a payment intangible or promissory note by sale under section 9-610 or by voluntary acceptance under section 9-620. This conclusion is reached by an examination of the text of sections 9-406 and 9-408, by the drafting history of those sections, and by analysis of the policies underlying those sections. The conclusion will not have adverse consequences even though it may lead to the further conclusion that the sale of certain payment rights under section 9-610 gives rise to a security interest in favor of the disposition-sale buyer.

I. TEXT OF THE SECTIONS

Section 9-406(d) overrides contractual transfer restrictions on, among other things, the "enforcement" of a security interest in certain payment rights, including payment intangibles and promissory notes. Section 9-406(e) states simply that section 9-406(d) does not apply to a "sale" of a payment intangible or promissory note. The language of section 9-406(e) does not distinguish between a voluntary sale by the debtor, a sale by disposition under section 9-610, or a disposition by voluntary acceptance in whole or partial satisfaction of the secured obligations under section 9-620. In fact, a voluntary acceptance constitutes a sale by the debtor to the secured party as noted in Official Comment 10 to section 9-620. If section 9-406(e) is read literally, as we think that it should, a sale under either section 9-610 or section 9-620 (either of such sales being referred to in this paper as a "sale by disposition") would constitute a sale within the meaning of section 9-406(e), and section 9-406(d) would not govern the transaction.

We do not think that giving "sale" its natural interpretation as including a disposition by sale creates an unacceptable tension with section 9-406(d). To be sure, section 9-406(d) renders ineffective a contractual transfer restriction on enforcement of a security interest in a payment intangible or promissory note. Enforcement under Part 6 of Article 9 generally includes the remedies of disposition under section 9-610, voluntary acceptance under section 9-620, and collection by the secured party under section 9-607. If section 9-406(e) applies to a sale by disposition, the contractual transfer restriction on enforcement would not be overridden by section 9-406(d). Hence, it might be argued that, if section 9-406(e) applies to sales by disposition, the only effective statutory enforcement remedy available to a secured party whose security interest in a payment intangible or promissory note secures an obligation is collection under section 9-607. The narrowing of the secured party's statutory enforcement remedies, the argument goes, so limits the application of section 9-406(d)'s override of a contractual transfer restriction on enforcement that such a result could not have been intended.

But this argument ignores other remedies available to a secured party beyond collection. The secured party has the right to proceed judicially by seeking a judgment or seeking other judicial remedies, all as permitted by section 9-601(a)(1). The secured party also has whatever other remedies are provided in the security agreement. *See* section 9-601(a) (rights "provided in the agreement of the parties"). In certain circumstances, these remedies may significantly augment the remedy of collection. If section 406(e) is applied to sales by disposition, section 9-406(d) would still have wide application to payment intangibles and promissory notes.

We also think that section 9-406(e)'s application to sales by disposition is supported by other provisions of Part 4 of Article 9. Section 9-408(b) refers specifically to a security interest that "arises out of a sale of the payment intangible or promissory note". That section 9-406(e) does not use the phraseology of section 9-408(b) suggests that a broader scope of application was intended for section 9-406(e), *i.e.*, application not only to a security interest created voluntarily by a sale to which section 9-408(b) refers (whether as a sale *ab initio* or as a sale under section 9-620 that occurs by voluntary acceptance of collateral that secures an obligation), but also to a sale under section 9-610 on enforcement of security interests that secure obligations.

Section 9-401(a) gives that suggestion very strong weight. Section 9-401(a) leaves to other law the question of whether the debtor's rights in collateral may be voluntarily or involuntarily transferred except as otherwise provided in, among other specified provisions, sections 9-406 and 9-408. As Official Comment 4 to section 9-401 points out, the general intent of section 9-401(a) is to leave to other law the question of whether the debtor's rights in collateral may be voluntarily or involuntarily transferred "subject to *identified* sections" (emphasis added). Given section 9-401(a)'s residual rule of leaving to other law the alienability of the debtor's rights in payment intangibles and promissory notes unless otherwise specified in sections 9-406 and 9-408, we think that any ambiguity as to whether section 9-406(e) should apply to a contractual transfer restriction on a sale by disposition of a payment intangible or promissory note under section 9-610 should be resolved in favor of that application so that the matter is left, consistent with section 9-401(a)'s residual rule, to other law.

II. DRAFTING HISTORY

Our recollection of the drafting history of sections 9-406 and 9-408 is that the drafting committee was sensitive to the effect on the loan participation and syndicated loan market of including, within the scope of Article 9, sales of payment intangibles and promissory notes. The drafting committee did not want to disturb the contractual transfer restrictions that borrowers often negotiate in loan agreements identifying who they must recognize as their lenders. For example, it would not be unusual for a borrower to negotiate a provision in a loan agreement that the lender may not sell the loan to a vulture fund or to a competitor of the borrower. The drafting committee did not want unduly to interfere with those contractual transfer restrictions in the market place for any loan that might be classified under Article 9 as a payment intangible or promissory note. See Steven L. Harris and Charles W. Mooney, Jr. "How Successful was the Revision of UCC Article 9: Reflections of the Reporter," 74 Chicago-Kent Law Review 1357 at footnote 65 (1999).

Section 9-408(a) reflects this sensitivity. It evidences the intent of the drafting committee not to expand the override of a contractual transfer restriction pertaining to a payment intangible or promissory note beyond permitting the creation, attachment, and perfection of a security interest arising out of the sale of the payment intangible or promissory note. We think that section 9-406(e) reflects a similar sensitivity when the security interest secures an obligation and is later enforced by a sale by disposition. We believe that the drafting committee did not want to interfere with a contractual transfer restriction that might limit who the borrower must recognize as a qualified lender by requiring that the borrower deal with the buyer of the loan following a sale by disposition.

It may appear anomalous that under our interpretation a debtor may sell a payment intangible or promissory note under section 9-408(a) notwithstanding an otherwise effective contractual transfer restriction but a secured party may not enforce its security interest in the same payment intangible or promissory note subject to the same contractual restriction in a sale by disposition under section 9-610. However, this result is understandable given the narrow application of former section 9-318(4) and the drafting committee's concern about not expanding the provisions of Article 9 overriding contractual transfer restrictions in a way that would interfere unduly with the use of those restrictions in the loan participation and syndication markets.

To be sure, former section 9-318(4) could have been read to override a contractual transfer restriction on enforcement of a security interest by sale of a general intangible due or to become due. Interpreting section 9-406(e) to cut back on that override for what is now referred to under Article 9 as a payment intangible would be to deny the secured party a remedy that was arguably available under former law.

However, the full effect of former section 9-318(4) on a contractual transfer restriction on the enforcement of a security interest in a general intangible for money due or to become due via sale was unclear under former Article 9. Since sales of general intangibles for money due or to become due were outside of the scope of former Article 9, it was uncertain whether former section 9-318(4) even applied to a contractual transfer restriction on enforcement of a security interest by sale of a general intangible due or to become due.

In any event, former section 9-318(4) did not override a contractual transfer restriction on the enforcement of a security interest in a promissory note via sale since such a restriction was not within the scope of the section. Thus, overriding a contractual transfer restriction on enforcement of a security interest in a promissory note securing an obligation would provide the secured party with a remedy that was not available under former Article 9. There is no basis for reading sections 9-406(d) and 9-406(e) in a manner that treats a contractual restriction on a payment intangible differently than a contractual restriction on a promissory note.

Given the drafting committee's concern about not interfering unduly with contractual transfer restrictions in the loan participation and syndication market, we think the drafting committee would not have intended in Article 9 to expand from former Article 9 the contractual transfer restriction override by applying it to a sale by disposition of a promissory note securing an obligation. It follows that the drafting committee would not have intended to apply the contractual transfer override to a sale by disposition of a payment intangible securing an obligation.

III. POLICY

The interpretation of section 9-406(e) as applying to a sale by disposition of a payment intangible or promissory note that secures an obligation is strengthened on policy grounds.

Direct vs. indirect sale

We see no policy reason for sections 9-406(d) and (e) to be interpreted to permit a contractual transfer restriction that would be effective in a voluntary sale of a payment intangible or promissory note to be overridden indirectly in a sale by disposition. Consider the following example if such an interpretation were adopted:

> Finance Company loans money to Borrower. The loan is either a payment intangible or a promissory note. Borrower negotiates with Finance Company a contractual transfer restriction in the loan agreement that Finance Company will not sell the loan to a competitor of Borrower without Borrower's consent. Finance Company borrows money from Lender and grants to Lender a security interest in the loan to secure Finance Company's loan obligations to Lender. Finance Company defaults on its loan obligations to Lender, and Lender sells the loan under section 9-610 to Buyer, a competitor of Borrower. Buyer is now able to enforce the loan against Borrower, if Borrower defaults, in such a way as to eliminate Borrower as a competitor. If Finance Company had sold the loan directly to Buyer rather than using it as collateral for an obligation, then under sections 9-408(a) and (d) the transfer restriction, if effective under other law, would have prevented Buyer from enforcing the loan against Borrower.

Interpreting section 9-406(e) not to apply to a sale by disposition under section 9-610 would mean that a contractual transfer restriction that prevented a voluntary direct sale of a payment intangible or promissory note by the debtor would not prevent an indirect sale by the secured party through enforcement of a security interest securing an obligation. There is no policy justification for this different outcome. To the extent that a contractual transfer restriction on a voluntary sale by the debtor of a payment intangible or promissory note is to respected, a contractual transfer restriction on a disposition sale by the secured party arising from a security interest that secures an obligation should be respected as well.

Sale by disposition under section 9-610 vs. voluntary acceptance under section 9-620

We also see no policy reason for sections 9-406(d) and (e) to be interpreted to provide for a contractual transfer restriction on a sale of a payment intangible or promissory to be overridden through a sale by disposition under section 9-610 if the contractual transfer restriction would not have been overridden had the secured party proposed to accept the payment intangible or promissory note in whole or partial satisfaction of the secured obligations under section 9-620. Consider the following example if such an interpretation were adopted:

Finance Company loans money to Borrower. The loan is either a payment intangible or a promissory note. Borrower negotiates with Finance Company a contractual transfer restriction in the loan agreement that Finance Company will not sell the loan to a competitor of Borrower without Borrower's consent. Finance Company borrows money from Lender and grants to Lender a security interest in the loan to secure Finance Company's loan obligations to Lender. Finance Company defaults on its loan obligations to Lender, and Lender sells the loan under section 9-610 to Buyer, a competitor of Borrower. Buyer is now able to enforce the loan against Borrower, if Borrower defaults, in such a way as to eliminate Borrower as a competitor.

If Lender were itself a competitor of Borrower and Lender had proposed to accept the loan in whole or partial satisfaction of Finance Company's loan obligations to Lender, then under sections 9-408(a) and (d) the transfer restriction, if effective under other law, might have prevented Lender from enforcing the loan against Borrower after acceptance. This would be the case if an acceptance of the loan with the consent, or in the absence of objection, by Finance Company is viewed in effect as a sale of the payment intangible or promissory note by Finance Company to Lender. The interest of Lender in the payment intangible or promissory note would then be a security interest. See Official Comment 10 to section 9-620. On account of section 9-408(b), section 9-408(a) would apply to the security interest created by sale. The transfer restriction would not be overridden under section 9-408(a) to the extent that it relates to post-acceptance enforcement of the loan by Lender against Borrower. See also section 9-408(d).

As noted in the example, in the case of a voluntary acceptance under section 9-620, Official Comment 10 makes it clear that the interest of the secured party is that of an ordinary buyer of the payment intangible or promissory note, meaning that it is a security interest. If, on account of section 9-408(b), section 9-408(a) would apply when the secured party is the buyer under section 9-620, the same result should be reached in the case of a buyer at a foreclosure sale conducted under section 9-610. Interpreting section 9-406(e) not to apply to a sale by disposition under section 9-610 would mean that a contractual transfer restriction that prevented post-acceptance enforcement by the secured party of the payment intangible or promissory note would not prevent, in the case of a security interest securing an obligation, post-disposition enforcement by a foreclosure-sale buyer of the payment intangible or promissory note. There is no policy justification for this different outcome. If voluntary acceptance of collateral is viewed merely as a sale of the collateral by the debtor to the secured party, then, to the extent that a contractual transfer restriction on an acceptance of a payment intangible or promissory note in whole or partial satisfaction of secured obligations is to be respected, a contractual transfer restriction on a sale by disposition under section 9-610 should be respected as well.

Payment intangible vs. general intangible

We also see no policy reason for sections 9-406(d) and (e) to be interpreted to provide for a contractual transfer restriction on a sale of a payment intangible or promissory note to be overridden through a sale by disposition when a contractual transfer restriction on the sale of a general intangible, which is not a payment intangible but has associated payment rights, would not be overridden by Article 9.

With payment intangibles, there may be non-payment rights associated with a right to payment that, standing alone, would constitute an "ordinary" general intangible (by which we mean a general intangible that is not a payment intangible). If the non-payment associated rights represent the principal obligation of the account debtor, the entire package of rights would be an ordinary general intangible and all the rights, including the rights to payment, would be excluded from section 9-406(d). A sale of the ordinary general intangible would be entirely outside of the scope of Article 9, and a security interest in the ordinary general intangible created to secure an obligation would be addressed under section 9-408(a) and (d). In either case, though, a contractual transfer restriction on enforcement of a security interest in an ordinary general intangible would not be overridden by Article 9 if the contractual transfer restriction were effective under other law. Consider the following example if section 9-406(e) were interpreted not to apply to dispositions by sale:

> Seller sells a division of its business to Buyer. Under the acquisition agreement, Seller agrees to reimburse Buyer for any inaccuracy in Seller's representations and warranties in the acquisition agreement and also agrees not to compete with Buyer in the business sold. The acquisition agreement contains a restriction on Buyer selling its rights under the acquisition agreement without Seller's consent.
>
> Buyer borrows money from Lender and grants to Lender a security interest in Buyer's rights under the acquisition agreement. If the primary obligation of Seller under the acquisition agreement is its obligation to reimburse Buyer for inaccuracies in Seller's representations and warranties, Buyer's rights under the acquisition agreement constitute a payment intangible. Upon Buyer's default, Lender may sell the rights under the acquisition to a foreclosure-sale buyer notwithstanding the contractual transfer restriction, and the foreclosure-sale buyer may enforce Buyer's rights under the acquisition agreement against Seller. However, if the primary obligation of Seller under the acquisition agreement is not to compete with Buyer, then Buyer's rights under the acquisition agreement constitute an ordinary general intangible. In view of the contractual transfer restriction, whether Lender may, upon Buyer's default, sell the rights under the acquisition agreement to a foreclosure-sale buyer, and, if Lender may do so, whether the foreclosure-sale buyer may enforce Buyer's rights under the acquisition agreement against Seller, will be determined under other law.

If section 9-406(e) is interpreted not to apply to sales by disposition, a secured party with a security interest in a payment intangible securing an obligation would be able to effect a sale by disposition of the payment intangible under section 9-610 notwithstanding a contractual transfer restriction. The disposition would enable the foreclosure-sale buyer to exercise full enforcement rights against the account debtor. However, if the sale were of an ordinary general intangible, Article 9 would not apply, and any contractual transfer restriction on the sale of the ordinary general intangible would not be disturbed by Article 9. We see no policy reason to provide complete protection to an account debtor from recognizing the foreclosure-sale buyer if the non-payment rights associated with a right to payment represented the principal obligation of the account debtor but to leave the transfer restriction undisturbed if the right to payment were a significant but not the principal obligation of the account debtor.

Contractual vs. legal transfer restriction

Furthermore, we see no policy reason for sections 9-406(d) and (e) to be interpreted to provide for a contractual transfer restriction on a sale of a payment intangible or promissory note to be overridden through a sale by disposition when a legal transfer restriction would not be overridden under sections 9-408(c) and (d) to the buyer. Consider the following example if such an interpretation were adopted:

> Finance Company loans money to Borrower. The loan is either a payment intangible or a promissory note. Borrower negotiates with Finance Company a contractual transfer restriction in the loan agreement that Finance Company will not sell the loan to a foreign investor without Borrower's consent. Finance Company borrows money from Lender and grants to Lender a security interest in the loan to secure Finance Company's loan obligations to Lender. Finance Company defaults on its loan obligations to Lender, and Lender sells the loan under section 9-610 to Buyer, a foreign investor. If an applicable state law or regulation would have prevented Finance Company from selling the loan to Buyer, then under sections 9-408(c) and (d) the legal transfer restriction, if effective under other law, would have prevented Buyer from enforcing the loan against Borrower.

Interpreting section 9-406(e) not to apply to a sale by disposition of a payment intangible or promissory note would mean that a contractual transfer restriction that purports to prevent a sale of the payment intangible or promissory note through enforcement of a security interest securing an obligation would be overridden while a legal transfer restriction that prevents the same sale would not. There is no policy justification for this different outcome. To the extent that a legal transfer restriction on a sale of a payment intangible or promissory note is to respected, a contractual transfer restriction on a sale arising from a security interest that secures an obligation should be respected as well.

Relevance of the collection remedy

We do not believe that the fact that the practical effect of a secured party's exercise of its remedy of collection under section 9-607 is a sufficient justification, in terms of policy, for an interpretation that section 9-406(e) does not apply to a sale by disposition. We understand the argument that, since the secured party with a security interest in a payment intangible or promissory note securing an obligation would be able to collect on the payment intangible or promissory note from the account debtor or person obligated notwithstanding a contractual transfer restriction, it should not matter, as a practical matter, whether collection is accomplished by the secured party or by a buyer at a foreclosure sale.

Furthermore, we recognize that section 9-406(d) overrides a contractual transfer restriction on the secured party's collection of a payment intangible or promissory note securing an obligation while section 9-406(f) does not override a legal transfer restriction on the secured party's collection. Accordingly, it could be argued that, notwithstanding our policy argument above against distinguishing contractual from legal transfer restrictions on a sale of a payment intangible or promissory note, there is precedent in Part 4 of Article 9 for overriding a contractual transfer restriction, but not a legal one, in the case of collection on a payment intangible or promissory note.

But collection on a payment intangible or promissory note is not ownership of the payment intangible or promissory note. From the point of view of the account debtor on a payment intangible or person obligated on a promissory note, the collection remedy merely implicates who the account debtor or person obligated must pay in order to obtain a discharge unless and until the debtor redeems the collateral by paying the secured obligations. Moreover, if the secured party has recourse against the debtor, the secured party must collect on the payment intangible or promissory note in a commercially reasonable manner. The requirement of commercial reasonableness may not be waived by the debtor, even after default. See section 9-602(3).

The stakes, from the point of view of the account debtor or other obligor, are much higher in the case of a sale by disposition. The debtor's right of redemption is cut off; the transfer of the right of collection is permanent. There is no longer any requirement that the collection be made in a commercially reasonable manner.

Perhaps more importantly, the transfer of ownership of a payment intangible or promissory note may result in undesirable legal, regulatory, or tax consequences for the account debtor or person obligated that would not be present if ownership had not been transferred and the secured party was merely exercising its remedy of collection. Payment intangibles and promissory notes may consist of loans or debt instruments. Under some circumstances, ownership of debt instruments that might be viewed as securities under federal or state law may be transferred only to those who meet certain net worth or sophistication requirements under applicable federal or state securities laws. Some debt instruments may not be owned by certain ERISA qualified trusts, non-profit organizations or foreign investors without fines or other penalties being imposed on the issuer. Some issuers of debt instruments, especially those convertible into equity of the obligor, may lose net operating losses or other tax attributes in the case of a transfer of ownership of the debt instruments.

In balancing the interests of the secured party versus those of the account debtor or person obligated, there is more justification from a policy perspective in overriding a contractual transfer restriction on collection but not on disposition via sale and for overriding a contractual transfer restriction, but not a legal transfer restriction, on collection but not on a disposition via sale.

Impact on loan and capital market transactions

Finally, we are very concerned about the effect on many loan and capital markets transactions if sections 9-406(d) and (e) were to be interpreted to provide for a contractual transfer restriction on a payment intangible or promissory securing an obligation to be overridden through a sale by disposition.

Contractual transfer restrictions on the sale of payment intangibles and promissory notes play an extremely important role in loan and capital markets transactions. Not only do loan agreements often provide for restrictions on who the borrower is required to recognize as a lender, as mentioned above, but also various debt instruments in the capital markets may restrict who the issuer must recognize as holders of its debt instruments. As suggested above, these transfer restrictions, in so far as they relate to who the account debtor or person obligated must recognize as the obligee, meet legitimate commercial, legal, regulatory, and tax expectations of the parties and should not be overridden without substantial justification.

Our concern is particularly acute if none of the protections expressly set forth in section 9-408(d) apply to a sale by disposition of a payment intangible or promissory note securing an obligation. Consider the following example if such an interpretation were adopted:

> Finance Company loans money to Borrower. The loan is either a payment intangible or a promissory note. The loan agreement provides that Borrower will provide to Finance Company from time to time confidential financial information relating to Borrower's business. Borrower negotiates with Finance Company a contractual transfer restriction that Finance Company will not sell the loan to a competitor of Borrower. Finance Company borrows money from Lender and grants to Lender a security interest in the loan to secure Finance Company's loan obligations to Lender. Finance Company defaults on its loan obligations to Lender, and Lender sells the loan under section 9-610 to Buyer, a competitor of Borrower. Buyer insists on obtaining the confidential financial information relating to Borrower's business that Borrower was obligated to provide to Finance Company under the loan agreement. If Lender had merely sold the loan to Buyer, then under sections 9-408(a) and (d) the transfer restriction, if effective under other law, would have prevented Buyer from obtaining the information.

The same concerns would arise if Lender had voluntarily accepted the collateral in full or partial satisfaction of the secured obligations under section 9-620. Our interpretation of section 9-406(e) as applying to any sale by disposition would avoid these issues. The effect of a contractual transfer restriction on a sale by disposition would be left to other law. This would be the case whether one looked to section 9-408, which defers to the effect of other law on the contractual transfer restriction, or whether one looked to other law directly.

IV. A DISPOSITION SALE UNDER SECTION 9-610 OF CERTAIN PAYMENT RIGHTS MAY GIVE RISE TO A SECURITY INTEREST IN FAVOR OF THE BUYER

We recognize that our interpretation of section 9-406(e) may lead to the conclusion that a sale by disposition of accounts, chattel paper, payment intangibles, or promissory notes under section 9-610 gives rise to a security interest in favor of the disposition-sale buyer. That conclusion may follow because sections 9-109(a)(3) and 9-406(e) each refer to a "sale" of payment intangibles and promissory notes, and it may be hard to interpret "sale" differently in section 9-109(a)(3) than in section 9-406(e). But, even if our interpretation of section 9-406(e) led to that conclusion, we still think that our interpretation is right.

The analysis of this issue is complicated by two Official Comments. Official Comment 2 to section 9-617 tells us that a buyer at a foreclosure sale is not a "purchaser" since the foreclosure sale is involuntary. See section 1-201(a)(30), (29), defining "purchaser" and "purchase." Official Comment 10 to section 9-620 tells us that a secured party that acquires payment rights by acceptance under section 9-620 has a buyer's security interest. The secured party's acceptance of the payment rights is voluntary on the part of the debtor since the debtor may object to the acceptance and, if the debtor does so, the acceptance may not proceed.

From these two Official Comments one might infer that a person that acquires payment rights by involuntary disposition under section 9-610 does not have a buyer's security interest. The inference leads to the argument that, since the definition of "purchaser" is limited to persons acquiring interests voluntarily and includes a person taking by security interest, all secured parties must acquire their interests in voluntary transactions.

However, the text of the Uniform Commercial Code is to the contrary. Section 9-109(a)(3) states that, except as otherwise provided in that section, Article 9 applies to a sale of accounts, chattel paper, payment intangibles, or promissory notes. The language is broad and inclusive, and it is not limited to sales voluntarily made by the debtor.

In fact, a security interest in an asset under the Uniform Commercial Code is not limited to an interest in the asset acquired voluntarily from the debtor so long as the transaction by which the security interest has its origin arises from a voluntary act by the debtor relating to that asset and governed by the Uniform Commercial Code. For example, a prepaying buyer that rightfully rejects goods has a security interest in the goods under section 2-711(3). Similarly, the interest of a collecting bank in an item under section 4-210 and the interest of an issuer or nominated person in a document presented under a letter of credit is a security interest. The prepaying buyer, the collecting bank, and the issuer or nominated person are all secured parties under section 9-102(a)(72)(F). All of these security interests are rooted in a voluntary transaction by the debtor – the purchase of goods, the deposit of a check, the application for a letter of credit or request for nomination - without a further voluntary act by the debtor itself later creating the security interest.

Likewise, the interest of a disposition-sale buyer of accounts, chattel paper, payment intangibles, or promissory notes has its origin in a voluntary act by the debtor relating to the payment right and governed by the Uniform Commercial Code - the debtor's original grant of the security interest to the secured party. The security interest of the disposition-sale buyer thus may arise without a further voluntary act by the debtor to create the security interest, just as the security interest of a prepaying buyer, collecting bank, or issuer or nominated person arises without a further voluntary act by the debtor.

Accordingly, we conclude that it is not necessary that a disposition-sale buyer of accounts, chattel paper, payment intangibles, or promissory notes be a "purchaser" at the foreclosure sale in order to have a security interest. The disposition-sale buyer need only be a buyer to have a security interest, as section 1-201(35) states. If a sale by disposition under section 9-610 is governed by Article 9, then the interest of the disposition-sale buyer is a security interest and the disposition-sale buyer is a secured party.

If the interest of a buyer at a sale by disposition under section 9-610 gives rise to a new security interest, we are not concerned that the buyer will need a new security agreement authenticated by the debtor and describing the collateral in order for the buyer's security interest to attach under section 9-203(b)(3)(A). It is true that most such sales of payment rights are voluntarily undertaken by the debtor and that the ordinary rules for attachment apply. We also recognize that in a disposition sale under section 9-610, since title passes from the debtor to the buyer through the intermediation of the secured party, the debtor is the real seller. However, the debtor will have already authenticated a security agreement with the enforcing secured party. That security agreement should be sufficient to satisfy the requirements of section 9-203(b)(3)(A). There is no policy reason to require a new security agreement in the case of a sale by disposition under section 9-610 any more than there is to require a new security agreement in the case of a sale by disposition under section 9-620. See Official 10 to section 9-620 ("the procedures for acceptance of collateral under this section satisfy all necessary formalities and a new security agreement authenticated by the debtor would not be necessary"). Both dispositions have their origin in a voluntary security interest granted by the debtor.

Furthermore, if the interest of a buyer at a sale by disposition under section 9-610 gives rise to a new attached security interest, we are not concerned that the buyer will need to take steps for the security interest to be perfected. Of course, in the case of a sale by disposition under section 9-610 of payment intangibles or promissory notes, the buyer's security interest would be automatically perfected under sections 9-309(3) and (4). However, in the case of a sale by disposition under section 9-610 of accounts or chattel paper, the buyer would need to take additional steps as required under sections 9-310(a), 9-313(a), or 9-314(a), as applicable, to perfect its security interest and, in the case of chattel paper, to obtain priority under section 9-330.

A cautious buyer of accounts and chattel paper in a sale by disposition under section 9-610 *should* take the appropriate steps to perfect its security interest and, in the case of chattel paper, to obtain priority under section 9-330. Official Comment 10 to section 9-620 suggests that caution. If an acceptance of accounts or chattel paper by the secured party under section 9-620 is a sale of the accounts or chattel paper by the debtor to the secured party and gives rise to a new security interest, the same may be said of a sale by disposition under section 9-610. It is true that an acceptance of collateral under section 9-620 may be distinguished from a sale by disposition under section 9-610 since an acceptance of collateral is more of a voluntary transaction by the debtor than a sale by disposition under section 9-610. However, consistent with our analysis above, that is not a basis for distinguishing the two transactions. Both transactions have their origin in a voluntary security interest granted by the debtor. Moreover, in the case of accounts or chattel paper, requiring the additional perfection steps accomplishes the policy goals of Article 9 by alerting third parties to the interest of the buyer.

Article 9 gives the buyer at a sale by disposition under section 9-610 the ability to perfect its security interest. Consistent with our view that the buyer's interest will have attached on account of the original security agreement authenticated by the debtor, the buyer will be authorized by section 9-509(b) to file a financing statement against the debtor by virtue of that security agreement. The buyer may also obtain an assignment of the secured party's financing statement against the debtor. If the sale is of chattel paper, the buyer will in any event likely obtain possession or control of the chattel paper to ensure itself of the priority of its interest.

In the case of a sale by disposition under section 9-620, as Official Comment 10 to section 9-620 points out, the accepting secured party's interest in the accounts or chattel paper would be perfected in any event by the secured party's financing statement already filed against the debtor.

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APPLICATION OF UCC § 9-406 TO POST-DEFAULT DISPOSITION OF PAYMENT RIGHTS

Neil Cohen and Steve Weise

April, 2008

Background

- Two sections in Article 9 limit the effectiveness of otherwise enforceable contractual restrictions on the assignment of accounts, chattel paper, payment intangibles (and other general intangibles), and promissory notes - UCC sections[1] 9-406 and 9-408. There is general agreement about the meaning and application of these sections except for one specific circumstance - whether, in the case of a security interest in a payment intangible or a promissory note[2] that secures an obligation,[3] a contractual restriction on transfer of the payment right is effective to limit post-default disposition[4] of the collateral under § 9-610.
    - Sections 9-406(d) and 9-408(a) each provide rules that invalidate or limit restrictions on the assignment of payment rights. The rules are somewhat different in scope, though:
        - Section 9-406(d) provides that, in the case of a security interest in an account, chattel paper, payment intangible, or promissory note, the anti-

[1] Unless otherwise indicated, all further statutory references in this paper are to the UCC.

[2] For convenience, this paper refers collectively to payment intangibles and promissory notes as "payment rights."

[3] UCC § 1-201(b)(35) defines the term "security interest" to include both an interest in property that secures an obligation and the interest of a buyer of certain payment rights. The differences between those two types of "security interest" are important to the analysis in this paper. Thus for convenience this paper uses nomenclature that distinguishes between the two types of security interests by referring to a security interest in property that secures an obligation as a "pledge" of that property.

[4] The word "disposition" (and its variations) is used as that word is used in § 9-610(a) ("After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.")

assignment restrictions are ineffective to interfere with the creation, attachment, perfection, or *enforcement*[5] of the security interest.

- Section 9-408(a) provides that, in the case of a security interest in a promissory note, health-care-insurance receivable, or general intangible, the anti-assignment restrictions are ineffective to interfere with creation, attachment or perfection of the security interest. § 9-408(a) does not mention "enforcement" of the security interest, and the omission of "enforcement" from § 9-408(a) is reinforced by § 9-408(d).

- Thus, when § 9-406(d) applies, contractual restrictions are ineffective to interfere with enforcement of the security interest; when § 9-408(a) applies, though, that section does not override restrictions that interfere with *enforcement* of the security interest.

- Which, if either, of the two sections applies to the situation that is the subject of the disagreement that generated this paper (post-default enforcement, by disposition, of pledged payment rights) is determined by two other provisions in those sections

  - Section 9-406(e) provides that § 9-406(d) does not apply to the *sale* of a payment intangible or promissory note.[6]

  - Section 9-408(b) provides that § 9-408(a) applies to a security interest in a payment intangible or promissory note *only* if the security interest arises out of the *sale* of the payment intangible or promissory note.

- There is general agreement that § 9-406(d) applies, and renders a contractual restriction ineffective, to the extent that the restriction would limit the ability of the secured party to collect on the payment right pursuant to § 9-607. Steve and Neil disagree with Ed and Bill, though, about the effect of §§ 9-406(e) and 9-408(b) (the scope subsections of §§ 9-406 and 9-408 noted above) and, thus, about whether § 9-406(d) or § 9-408(a) applies to determine whether a contractual restriction on assignment of a payment right is effective to interfere with post-default enforcement of a pledge of that payment right by disposition of it under § 9-610 (as opposed to collection of the payment right).

  - If Steve and Neil are right, a secured party that wishes to enforce its pledge of a payment right by disposing of it under § 9-610 can do so without regard to the contractual restriction because of § 9-406(d)

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[5] Emphasis is added.

[6] § 9-406(i) also limits the scope of § 9-406(d) by providing that it does not apply to assignment of a health-care-insurance receivable

- If Bill and Ed are right, a secured party that wishes to enforce its pledge of a payment right by disposing of it under § 9-610 is subject to the contractual restriction (as discussed in detail below)

What is the difference between the Steve/Neil position and the Ed/Bill position?

- The difference arises from different interpretations of §§ 9-406(e) and 9-408(b).
- Steve and Neil believe that the better interpretation of § 9-406(e) is that it excludes from the coverage of § 9-406(d) only those transactions that are themselves "sales" of payment intangibles and promissory notes governed as such by Article 9 and does not exclude from the coverage of § 9-406(d) any aspect of creation, attachment, perfection, or *enforcement* of a pledge of a payment right.
  - Therefore, in the case of a pledge of a payment right, Steve and Neil believe that the effect of a contractual restriction on the transfer of the payment right on *enforcement* of the pledge, including post-default enforcement by disposition of the payment right pursuant to § 9-610, is determined by § 9-406(d) (and not § 9-408(a) or other law).
  - Steve and Neil not only believe that this is a more natural reading of the relevant sections, but also believe that that the § 9-406(e) exclusion can only apply to "sales" of payment rights that are themselves transactions governed as such by Article 9 and that a post-default disposition of a payment right is not a "sale" of a payment right that is governed by Article 9.
  - Applying § 9-406(d), Steve and Neil believe that the contractual restriction on transfer would be ineffective to limit post-default enforcement of a pledge by disposition pursuant to § 9-610.
  - Moreover, as noted later in this paper, Steve and Neil believe that application of the Ed/Bill approach would generate disquieting implications in several other Article 9 contexts.
- Ed and Bill believe that the better interpretation of § 9-406(e) is that it excludes from the coverage of § 9-406(d) not only transactions that are "sales" of payment rights that themselves are governed as such by Article 9, but also excludes from § 9-406(d) post-default enforcement by the secured party of a pledge of a payment right pursuant to § 9-610 by a disposition of the payment right effectuated by selling the payment right even if that disposition is not a "sale" governed as such by Article 9.[7]

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[7] Ed and Bill also indicate that § 9-401 suggests a statutory policy that any statutory ambiguity should be resolved in favor of upholding a restriction on transfer. It is difficult to see how that policy emerges from the statutory language. Moreover, we believe that, to the extent there is a statutory view on restrictions on transfer, it is the view expressed in Official Comment 4 to former UCC § 9-318, which dismissed the

(Footnote continued)

- Thus, under the Ed/Bill interpretation, § 9-406(d) would apply to make a contractual restriction on transfer of a payment right ineffective to prevent creation, attachment, or perfection of a pledge of a payment right, but, if the debtor defaults on the obligation secured by the payment right, § 9-406(d) would *not* apply to enforcement of the pledge by the secured party by disposition pursuant to § 9-610.
- Thus, notwithstanding § 9-406(d), under the Ed/Bill view, the contractual restriction on transfer of the payment right would be effective to prevent post-default enforcement of a pledge of the payment right by disposition under § 9-610, even though the same restriction on transfer of the payment right is ineffective to prevent creation of the pledge or enforcement of it via collection by the secured party.

Is the difference between Steve/Neil and Ed/Bill a matter of differing views of secured transactions policy?

- Not really. Steve and Neil are not taking a position as to what a drafting committee (or the incipient Article 9 Review Committee) would or should conclude is better policy. Rather, we are trying only to interpret the words of the current statute faithfully, in the context of the provisions of Article 9.

Are the differences between the Steve/Neil position and the Ed/Bill position substantial in terms of their effect on an obligor of a payment intangible or promissory note?

- Not really. In the context that generated the PEB discussion about §§ 9-406 and 9-408 - the ability of a secured party to dispose of a pledged "transferable interest" in a limited liability company or limited partnership - the difference between the Steve/Neil position and the Ed/Bill position has been portrayed as a difference as to whether Article 9 fundamentally impinges on "know your partner" principle of LLC law and partnership law. Yet, both Steve/Neil and Ed/Bill agree that the law (both LLC law and the UCC) already limits that principle in many contexts similar to the one at hand. Thus, the "know your partner" principle, in this context, is hardly an inviolate principle. Rather, it is subject to so many exceptions that the exceptions may be more extensive than the rule itself. More generally, in light of the ability of a secured party with whom an obligor of a payment right has not agreed to deal to enforce the obligation of the obligor under § 9-607, the marginal practical impact on such an obligor of being subject to enforcement of the obligation by a disposition transferee with whom it has not agreed to deal is minimal.

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view in favor of limitations on transfer as being held by "those who still cherish the hope that we may yet return to the views entertained some two hundred years ago by the Court of King's Bench."

- First consider the following situations in which a "transferable interest" in an LLC is collateral for an obligation and the debtor defaults on the obligation. In each case, Steve/Neil *and* Ed/Bill agree that the LLC and its members must deal with a "stranger," notwithstanding the "know your partner" principle, even though the stranger is someone with whom the LLC has never agreed to deal and with whom the LLC might have a legitimate reason not to want to deal:
  - Notwithstanding a contractual restriction on transfer, the application of § 9-406(d) means that (i) a debtor who owns a transferable interest in an LLC can pledge that interest to a secured party without approval of the LLC and without liability therefor, (ii) the secured party can perfect such a pledge, and (iii) if the debtor defaults with respect to such a pledge, the secured party (who may be a stranger to the LLC) can collect payments owed on the transferable interest from the LLC (the account debtor) pursuant to § 9-607.
  - Notwithstanding a contractual restriction on transfer, if the debtor who pledged the transferable interest defaults and the secured party obtains a judgment, the secured party (who may be a stranger to the LLC) may also obtain a charging order pursuant to Re-ULLCA § 503(a). ("A charging order constitutes a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor." *Id.*)
  - Notwithstanding a contractual restriction on transfer, if the debtor who pledged the transferable interest defaults and the secured party obtains a judgment, under Re-ULLCA § 9-503(c) "upon a showing that distributions under a charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the transferable interest. The purchaser at the foreclosure sale only obtains the transferable interest [and] does not thereby become a member ..." Thus, the purchaser at the foreclosure sale (again, likely a stranger to the LLC) becomes the owner of the transferable interest.
  - Notwithstanding a contractual restriction on transfer, if (i) a guarantor has guaranteed the obligation of the debtor that is secured by the transferable interest, (ii) the debtor defaults, and (iii) the guarantor pays the secured party (thereby satisfying the debtor's obligation to the secured party), then the guarantor (again, likely a stranger to the LLC) is subrogated to the rights of the secured party under principles of suretyship and guaranty law and, thus, can collect on the transferable interest from the LLC pursuant to § 9-607.
  - To extend the analysis one step further, assume that the debtor incurs an obligation to a secured party secured by a pledge of the debtor's

transferable interest and the agreement between the debtor and the secured party does not contain an anti-assignment provision. Steve/Neil think, and believe that Ed/Bill agree, that, notwithstanding a restriction on transfer in the contract between the LLC and the debtor, if the secured party sells *its* payment intangible (the right to be paid the debtor) to Buyer, the debtor's obligation (which is now owed to Buyer) remains secured by the security interest in the transferable interest pursuant to § 9-203(g). Thus, if the debtor defaults on its payment obligation owed to Buyer, Buyer (again, likely a stranger to the LLC) may collect (as discussed above) on the transferable interest from the LLC pursuant to § 9-607.

- The same analysis applies to promissory notes and to payment intangibles not consisting of transferable interests in LLCs or limited partnerships. Consider the case of a loan from Lender to Account Debtor, governed by a loan agreement pursuant to which Lender agrees not to assign its rights to anyone else. By the above analysis, Steve/Neil and Ed/Bill agree that (i) notwithstanding the anti-assignment clause, Lender may pledge, to Creditor (who may be a stranger to Account Debtor or, worse, someone with whom Account Debtor might have a legitimate reason not to want to deal), Lender's right to be paid by Account Debtor, (ii) if Lender defaults on the obligation owed to Creditor that is secured by the pledge of the Lender's right to be paid, Creditor may enforce by collection the Loan Agreement against Account Debtor, etc.
- Thus, Steve/Neil *and* Ed/Bill agree that there are a large number of circumstances in which, notwithstanding an otherwise-enforceable restriction on transfer, an obligor on a payment right may be required to pay or otherwise deal with a stranger, even though the stranger is someone with whom the obligor has not agreed to deal and with whom the obligor might have a legitimate reason not to want to deal. Thus the "know your partner" principle is already substantially inapplicable and obligors on payment rights are already subject to enforcement by unwanted strangers when a payment right has been pledged.
- Accordingly, the difference between Steve/Neil and Ed/Bill is *not* over an otherwise inviolate principle that protects obligors who have negotiated for restrictions on transfer from having to pay or otherwise deal with strangers.
  - To the extent that that principle exists, it is riddled with exceptions both in and out of Article 9.
  - Rather, the difference between Steve/Neil and Ed/Bill is about whether one particular exception exists - whether, in the context of a pledge of a payment right, the account debtor can be compelled to deal with a person to whom the payment right was disposed pursuant to a disposition properly conducted under § 9-610.

The answer to the last question demonstrates that the stakes are not large to the obligor of the payment right. In light of the many exceptions to the know your partner principle catalogued above, a conclusion that the Steve/Neil position is correct would not result in a material diminution in the protections given to LLCs and other obligors of payment rights who have negotiated for contractual restrictions on transfer of those rights. Nonetheless, while this means that the Steve/Neil position should not be resisted on the grounds that it undermines a fundamental principle of obligor protection, it doesn't necessarily mean that the Steve/Neil position is the correct interpretation.

What arguments do Steve and Neil have that their interpretation of 9-406(e) is correct?

- Everyone agrees that § 9-406(e) is ambiguous and, standing alone, is susceptible of more than one interpretation. The question is which interpretation makes more sense in the context of other rules in Article 9. We think that the Ed/Bill reading (i) requires a strained reading of § 9-406(d), (ii) would bring about anomalous results with respect to restrictions on transfer, and (iii) would have disquieting implications outside §§ 9-406 and 9-408.

Strained reading of § 9-406(d).

- Under the Ed/Bill approach, it is conceded that § 9-406(d) applies to the pledge of a payment right. Yet § 9-406(d) renders contractual restrictions on the transfer of payment rights ineffective to the extent that they interfere not only with the creation, attachment, and perfection of a security interest in a payment right but also to the extent they interfere with the *enforcement* of a security interest in a payment right.
  - o Under the Ed/Bill interpretation of § 9-406(e), the override of contractual restrictions on enforcement of a pledge of a payment right would be limited to only one particular type of enforcement – collection under § 9-607.
  - o We think that if the drafters of § 9-406 had intended the word "sale" in § 9-406(e) to override the use of the word "enforcement" in the neighboring subsection, § 9-406(d), the drafters would not have used the unqualified word "enforcement" in §§ 9-406(d)(1) and 9-406(d)(2).

Anomalous results as to the effect of restrictions on transfer under §§ 9-406/9-408.

- Under the Steve/Neil view, §§ 9-406(d) and 9-406(a) would together occupy the entire field with respect to the effect of contractual restrictions on transfer of payment rights.
  - o In the case of a pledge of a payment right, § 9-406(d) would override transfer restrictions that interfere with all aspects of creation, attachment, perfection, and enforcement of the pledge.

- In the case of a sale of a payment right, § 9-408(a) (as limited by § 9-408(d)) would provide an override of contractual transfer restrictions for creation, attachment, and perfection, but not for enforcement.

- Under the Ed/Bill view, though, even in the context of a pledge of a payment right, the post-default *enforcement* of the pledge under § 9-610(a) by disposition of the payment right counts as a "sale" of the payment right.
  - Thus, under the Ed/Bill view § 9-406(d) does not apply to override the contractual restrictions insofar as they would otherwise prevent post-default enforcement by disposition (because, under the Ed/Bill interpretation of § 9-406(e), that subsection prevents application of § 9-406(d)).
  - But if the Ed/Bill interpretation is correct, § 9-408(a) – even as limited by 9-408(d) – also would *not* apply (for the reasons noted in the next bullet point) to override restrictions on the creation, attachment, and perfection of the disposition transaction pursuant to § 9-610.The result would be that *neither* § 9-406(d) nor § 9-408(a) would apply to *any* aspect of post-default disposition under § 9-610. Thus the contractual restriction on transfer would render the post-default disposition completely ineffective – not just ineffective to prevent enforcement by the transferee against the obligor of the payment right, but also ineffective so as to prevent the transferee of the payment right from being owner of the payment right for other purposes – anomalously giving the contractual restriction on transfer greater vitality to prevent a post-default disposition than to prevent a voluntary sale by the owner of the payment right. (After all, when § 9-408(a) applies, as all agree it does, to a transaction that is an outright sale of a payment intangible, restrictions on creation, attachment, and perfection of the sale transaction are ineffective.)
  - The reason that the § 9-408(a)(1) limited override of contractual restrictions on transfer would not apply to the post-default disposition is that § 9-408(a)(1) overrides only contractual restrictions that impair creation, attachment, and perfection of "security interests." *See* Comment 4 to § 9-408 ("This section does not render ineffective a restriction on an assignment that does not create a security interest").

- Why isn't the right of a transferee of a payment right in a § 9-610 post-default disposition a "security interest"? Two reasons:
  - First, as noted in comment 2 to § 9-617, a buyer at a post-default disposition via foreclosure sale is not a "purchaser." Thus, by definition, such a buyer must not have taken by "purchase." *See* §§ 1-201(b)(29)-(30). Because one who takes by security interest takes by purchase (*see* § 1-201(b)(29)), it must be the case that a buyer at a post-default disposition that did not take by "purchase" also did not take via "security interest."

- Second, § 1-201(b)(35) defines a security interest as either (i) an interest securing payment or performance of an obligation or (ii) the interest of a consignor or a buyer of accounts, chattel paper, a payment intangible, or a promissory note "<u>in a transaction that is subject to Article 9.</u>"
  - Thus, the buyer at a post-default disposition takes by security interest only if the disposition is a transaction to which Article 9 applies.
  - Article 9 applies to the disposition transaction only if it falls within one of the six paragraphs of § 9-109(a). The disposition transaction clearly does not fall within paragraphs (1), (2), (4), (5), or (6).
  - Does the disposition transaction fall within paragraph (3)? For the disposition to fall within paragraph (3), the disposition would have to be a "sale" of the payment right. In order to determine whether the disposition is a "sale," the definition of that term must be consulted. For this purpose, § 9-102(b) tells us to utilize the definition of "sale" in § 2-106. According to that section, a "sale" is "the passing of title from the seller to the buyer for a price." Given that definition, the post-default disposition of a payment right is not a "sale" of the payment right from the secured party to the transferee. This is because no "title" passes from the secured party to the transferee; indeed § 9-617(a)(2) tells us that the secured party's security interest (the closest thing to "title" that the secured party had) is *discharged* by the post-default disposition.
  - Thus, if the post-default disposition is to count as a sale, the "seller" must be the pledgor (the Article 9 debtor); after all, it is the pledgor's "title" that is passed from to the transferee. *See* § 9-617(a)(1). Yet, if the disposition to the transferee is somehow considered to be a "sale" governed by Article 9 because the debtor's "title" to the payment right is passed to the transferee, several illogical results would follow. For example, a security agreement with respect to the disposition would need to be entered into and authenticated by the *debtor* (i.e., the pledgor). Quite obviously, there is no pledgor-transferee agreement in the case of a post-default disposition, much less one that is authenticated by the pledgor; such a disposition goes forward without the necessity of the pledgor agreeing to it. *See* § 9-610(a).
  - Thus, a post-default disposition of a payment right should not be considered to be a "sale" of the payment right for purposes of § 9-109(a)(3), and if it is not such a sale the disposition does not create a security interest.

- Steve and Neil believe that the § 9-406(e) exclusion of sales of payment rights from the scope of § 9-406(d) and the statement in § 9-408(b) that § 9-408(a) covers "sales" of payment rights are intended to work together to result in one or the other of those sections governing the effect of a restriction on transfer on the post-default disposition of a payment right that is the subject of a pledge and not to create an anomalous gap in which neither section applies. *See* Comment 4 to § 9-408.

- Yet, the Ed/Bill approach would appear to exclude post-default disposition of pledged payment rights from § 9-406(d), but *not* include them in § 9-408. This would leave a hole in the application of Article 9 to the enforcement by disposition of the payment right. The Steve/Neil view, which limits the effect of the § 9-406(e) exclusion to Article 9 sales of payment rights that are within Article 9 and therefore within § 9-408 (and does not apply the exclusion to post-default enforcement of a pledge of payment rights) would not bring about this anomalous result.

Disquieting implications outside §§ 9-406 and 9-408.

- If, despite the above analysis, the post-default disposition of a payment right by disposing of it under § 9-610 is the creation of a security interest in the payment right that is governed by Article 9 (and, thus, as Bill and Ed argue, the § 9-406(e) exclusion applies to that disposition), two disquieting implications outside the context of transfer restrictions would follow from that conclusion:
  - As noted above, if the disposition of the payment right by foreclosure pursuant to § 9-610 is the creation of a security interest in the payment right, § 9-203(b) must be complied with in order for that security interest to attach and be enforceable[8].
    - This means that the "debtor" must have entered into and authenticated a security agreement in favor of the "secured party" (the disposition transferee) with respect to the security interest. Yet, as noted above, the "debtor" in the disposition transaction must be the pledgor of the payment right. Thus, the Ed/Bill theory would seem to require the pledgor to authenticate an agreement in favor of the foreclosure transferee when the pledged payment right is disposed of after the default of the pledgor.

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[8] Ed and Bill seek to avoid this implication, and those in the succeeding paragraphs, by suggesting that disposition of a pledged payment right pursuant to § 9-610 is a "sale" of the payment right for purposes of application of § 9-406(e), but is somehow *not* a "sale" of the payment right for purposes of § 9-109(a)(3) and, thus, that the disposition is not within the scope of Article 9 and the rules of Article 9 (except, apparently, § 9-406(e)) do not apply to the disposition. In light of the fact that "sale" is a defined term, and the same definition applies to both uses of the word sale, this argument is difficult to maintain.

- This would certainly be disquieting news to both the secured party and the transferee to whom the pledged payment right is disposed of, inasmuch as such cooperation by the pledgor is unlikely.

- Moreover, if the post-default disposition of a payment right is a "sale" of the payment right governed by Article 9 as a security interest in the payment right, it must also be the case that a post-default disposition of an *account* is a sale of the account governed by Article 9 as a security interest.

  - In the case of an account, though, not only must a security interest/sale be enforceable and must the right of the buyer/secured party have attached, but, because there is no automatic perfection pursuant to § 9-609 with respect to sale of accounts, the security interest/sale must be perfected for effectiveness against third parties.

  - This means that a financing statement would need to be filed with respect to the post-default disposition of the account. By the same analysis as above, the "debtor" of this security interest could only be the pledgor. Yet, the transferee of the account, as "secured party," would not be able to file a financing statement without the cooperation of the pledgor. After all, to file an initial financing statement with respect to the disposition transaction, the transferee/secured party would need the authorization of the pledgor in an authenticated record. *See* § 9-509(a). The pledgor is unlikely to provide such an authorization, and the *ipso facto* authorization provided in § 9-509(b) would be inapplicable because the pledgor did not authenticate a security agreement with respect to the disposition to the transferee.

  - The need to perfect a post-default disposition of an account, combined with the difficulty of doing so, would be disquieting to most secured parties and those to whom accounts are disposed after default, yet that would appear to be the necessary implication of the Ed/Bill approach.[9]

[9] Ed and Bill suggest that this should not be disquieting, citing Official Comment 10 to § 9-620 for the proposition that "a cautious buyer of accounts or chattel paper at a § 9-610 disposition *should* take appropriate steps to perfect the sale." Yet, that comment relates not to dispositions of the collateral under § 9-610, but to acceptance by the secured party of the collateral in full or partial satisfaction of the indebtedness it secures. Moreover, the comment makes the point that, *in the context of acceptance of the collateral*, neither a new security agreement nor a new financing statement is required in order to fulfill the requirements of enforceability or perfection. After all, there is already a security agreement between the parties to the acceptance transaction [the debtor and the secured party] and there is already a financing statement on file listing the debtor and the

(Footnote continued)

Even if the Steve and Neil's analysis is correct, is there a risk that this analysis will create the setting for an unscrupulous buyer of payment rights to structure its transaction as a pledge to take unfair advantage and use § 9-406?

- That won't work because:
  - Under Article 9, the substance of a transaction is determinative, not its form
  - Any buyer that set up a sale disguised as a pledge surely would not satisfy the good faith requirements of the UCC
  - It would be a poor plot in any event because the "pledgee" would have no assurance that it could buy the payment right at the public foreclosure sale; because the types of assets involved are not "customarily sold on a recognized market or the subject of widely distributed standard price quotations" the "pledgee" could not buy them at a private sale. § 9-610(c)(2).

This memo has discussed post-default enforcement of a pledge of payment rights by collection under § 9-607 and by disposition under § 9-610. What about the third type of post-default enforcement – acceptance of the payment rights as full or partial satisfaction of the secured obligation under § 9-620?

- The logic of the situation, juxtaposed with the text of Article 9, leaves us a bit confused here.
  - Steve/Neil and Ed/Bill agree that, after default, the secured party with respect to a pledge of a payment right can enforce the security interest by collecting on it pursuant to § 9-607, notwithstanding a contractual restriction on transfer of that payment right.
  - Steve and Neil additionally believe that the secured party can enforce the security interest in the payment right by disposition of it pursuant to § 9-610; if that disposition is by public disposition, the secured party can also be the transferee.
  - It would be certainly be anomalous if the secured party can enforce the security interest by collecting on the payment right in its role as secured party under § 9-607 (as all agree) and (under the Steve/Neil view) enforce the security interest by collecting on the payment right as its owner after a § 9-610 disposition, but is prevented from enforcing the security interest by becoming the owner of the payment right and thereby collecting on it under § 9-620.
    - ♦ Rather, it seems more logical and "tidy" to interpret § 9-406(d) as applicable to all modes of enforcement of a pledge of a payment right (i.e., a security interest in the payment right that does not arise from the sale of

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secured party. Neither of those things is true, though, in the context of a disposition to a third party under § 9-610.

the payment right) under Part 6 of Article 9, notwithstanding a contractual restriction on transfer, rather than to conclude that the subsection overrides restrictions with respect to two modes of enforcement but not the third mode.

- On the other hand, Comment 10 to § 9-620 indicates that "if the collateral is accounts, chattel paper, payment intangibles, or promissory notes, then a secured party's acceptance of the collateral in satisfaction of secured obligations would constitute a sale [presumably by the debtor] to the secured party. That sale normally would give rise to a new security interest ..." This comment could lead to the conclusion that acceptance under § 9-620 is a "security interest" and thus falls within the § 9-406(e) exclusion from § 9-406(d), even though disposition under § 9-610 does not fall within the exclusion. (It must be noted that there is no parallel comment in § 9-610 with respect to post-default disposition by the secured party.)
- Moreover, inasmuch as the debtor willingly participates in the acceptance transaction, any formalities required of the debtor in order to make the transaction enforceable, attached, and perfected present a less daunting prospect. (Comment 10 goes on to say that "the procedures for acceptance of collateral under this section satisfy all necessary formalities and a new security agreement authenticated by the debtor would not be necessary." This clearly makes sense in the context of a debtor who has consented to acceptance in full or partial satisfaction of the indebtedness in an authenticated record. We are not sure, though, how those procedures satisfy the requirement of an authenticated security agreement when the debtor has consented to acceptance in full satisfaction of the indebtedness by failing to object.)
- Finally, if acceptance of the collateral in full or partial satisfaction of the indebtedness is, indeed, an Article 9 "sale," § 9-408(b) would allow application of § 9-408(a) to that sale. Accordingly, the problem that Steve and Neil pointed out with respect to disposition under § 9-610 (which is not an Article 9 sale) being governed by neither 9-406 nor 9-408 would not be present for enforcement via acceptance of the collateral.

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New York Law School
MEMORANDUM

Mailing Address:
57 Worth Street
New York, New York
10013-2960

TO: EDWIN E. SMITH DATE: August 6, 2008

FROM: Kenneth C. Kettering

RE: Article 9 Review Committee – Statutory Modification Issues List (draft 6/24/08)

As comments are evidently being invited on the issues list at ABA annual meeting this weekend, and as I am not sure whether I will be able to attend, I respectfully submit two comments, as follows.

1. Issue III.B., Location of a federally registered organization. "**Issue**: Whether § 9-307(f)(2) should be modified to state more completely how federal law may designate the location of a debtor that is a registered organization under federal law."

I respectfully urge the Committee to consider a different approach to § 9-307(f), and revise it to provide simply that a registered organization organized under the law of the United States, and a branch or agency of a foreign bank, is located in the District of Columbia. The paramount criteria for designating a location of a debtor (aside from the location having an adequate filing system) are that the location be easy to ascertain and that it be reasonably stable. Geographic proximity of the filing office to the debtor is, by comparison, irrelevant. Designating the location of these entities to be the District of Columbia is simple and stable. The current approach leads to enormous waste of time for no good reason, for a secured party (whose counsel is not typically expert in the details of bank regulatory law that are involved here) is put to much effort and anxiety, first to judge whether relevant federal law contains a "designation" or "authorization" of the sort called for by this section, and then to to obtain and sort through the debtor's organic documents and/or regulatory filings to ascertain what they say (and that they have not been amended since they said it). This reference to bank regulatory law entails substantial investment of time and effort, to no practical benefit.

My recollection and belief is that the reference to location per bank regulatory law was in significant measure the result of a suggestion by Joe Sommer, who is, of course, very knowledgeable about bank regulatory law, but who is not primarily a secured transactions lawyer. I discussed the matter with him several times, and I believe that I convinced him thatreference to regulatory law for this purpose is a mistake. It was, however, far too late to implement any such change. The Review Committee offers the opportunity. There is, of course, a transition issue, but a smaller change to § 9-307(f) would also present transition issues.

2. Official Comments Modification Issues List. "**Issue:** Whether an Official Comment should clarify how the priority rules apply to a security interest that, under § 9-309(3) or (4), is perfected upon attachment and without filing, but as to which a financing statement nevertheless has been filed."

I respectfully urge the Committee to consider whether this subject can be addressed effectively by way of comment, as opposed to statutory revision. A strong implication can be drawn from § 9-513(c)(1) that a financing statement that covers sold payment intangibles or promissory notes is meaningless. If such a financing statement has effect, it should not be subject to termination as required by that provision. A similar argument can be based on § 9-505(a).

In the past I argued for adoption of a PEB commentary on this subject. A comment is better than nothing, and I am unwilling to say that the implications that can be drawn from § 9-513(c)(1) and

§ 9-505(a) are dispositive. However, these provisions do add to the argument for a statutory solution. (I am on the verge of finishing a law review article on true sale of receivables, in which I make essentially this point.)

KCK

cc: Neil Cohen
Steve Harris
Steve Weise

**Uniform Commercial Code Committee of the
Business Law Section of the State Bar of California**

November 5, 2006

BY EMAIL TRANSMISSION

Permanent Editorial Board for the
Uniform Commercial Code
c/o The American Law Institute
4025 Chestnut Street
Philadelphia, Pennsylvania 19104

Re: In re Commercial Money Center, Inc.

Ladies and Gentlemen:

We are writing to you on behalf of the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California (the "UCC Committee") to address certain specific concerns of the UCC Committee with respect to the decision In re Commercial Money Center, Inc.[1] (the "Case"). Considerable discussion has been generated over the Case, including on the Washburn University School of Law "UCCLaw-L -- UCC Law Discussion List" (the "UCC ListServ").[2] The UCC Committee wishes to supplement this discussion and, hopefully in the process, address some of the points raised in the UCC ListServ discussions. Please note that in this letter we have only included a basic summary of the issues and holdings in the Case, as we assume most are generally familiar with the Case.[3]

1. Summary of Issues and Holdings in the Case

A. Issue: Are the payment streams under the equipment leases "chattel paper" within the meaning of Section 9-102(a)(11) or "payment intangibles" within the meaning of Section 9-102(a)(61)?

Holding: The payment streams are payment intangibles.[4]

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[1] In re: Commercial Money Center, Inc., U.S. Bankruptcy Appellate Panel of the 9th Circuit, BAP No. SC-05-1238-MoTB; Bk. No. 02-09721-H7; Adv. No. 03-90331.

[2] See: http://lists.washlaw.edu/mailman/listinfo/ucclaw-l/.

[3] A further discussion on the background of securitizations, the commercial reasons for "stripping" and a schematic diagram of the Case and other securitization structures can be found in the Appendices to this letter.

[4] Although the court evidently believed that this legal conclusion is one of the holdings in the Case, some have argued that this legal conclusion amounts to "obiter dictum." For purposes of this letter, we will treat this legal conclusion as a holding (without attempting to resolve that debate).

B. Issue: Were the transactions concerned sales of the payment streams or loans secured by the payment streams?[5]

Holding: The transactions were loans, not sales.

C. Issue: Was NetBank's security interest in the payment streams perfected by possession of the related equipment leases?

Holding: The Case was remanded for a factual determination as to whether NetBank, through an agent, had possession of the equipment leases.

2. Loan vs. Sale

Of the holdings in the Case, the finding that the underlying transaction was a loan, and not a sale, appears to be uncontroversial. The transaction between the assignor (Commercial Money Center) and the assignee (NetBank) involving a pool of sub-prime equipment leases was found to be a loan and not a sale. The court reached this conclusion because the assignee had none of the potential benefits or risks associated with ownership of the lease chattel paper and equipment. In making this determination, the court rightfully looked to the substance of the allocation of risks in the transaction, and not the form or purported characterization of the transaction by the parties. Based on the court's conclusion, the assignee's security interest could be perfected either by filing a financing statement or by taking possession of the equipment leases. No financing statement was ever filed. However, because there was a dispute about whether the assignee had taken possession of the leases through an agent, the court remanded the Case for a determination of that factual issue.

3. "Stripping" and the Creation of Payment Intangibles

The court found that Commercial Money Center created payment intangibles by separately assigning its interest in the payment streams under certain equipment leases and its interest in the leases themselves, which, in the court's view, effectively "carved out" or "stripped" the payment streams from the underlying chattel paper (even though the separate assignments were made in the very same agreement).[6] This holding is controversial due to the possibility that a security interest in chattel paper which is

[5] If the transactions were sales, NetBank's interest in the payment streams would be automatically perfected upon attachment under Section 9-309(3); however, if the transactions were loans, NetBank's interest in the payment streams could be perfected only by filing under Section 9-310(a) or (according to the court after discussing a 1991 bankruptcy case) by taking possession of the related leases.

[6] We note that most loans secured by equipment leases (*i.e.*, lease receivable discounting agreements) use granting language that includes both (1) an assignment of the lease payments and (2) a grant of a security interest in the underlying lease chattel paper and the leased equipment. Under the analysis in the Case, these transactions create payment intangibles by the mere use of words that "strip" the lease payments from the underlying leases. Although we are not aware of any lenders attempting to rely on automatic perfection under Section 9-309 in what are clearly loan transactions, we believe that most lenders and lessors would be surprised to learn that they are creating payment intangibles when they use the typical granting language of a loan against a lessor's lease receivables.

perfected by filing or by possession may, as to the related payment rights, be subordinate to the interest of a prior buyer of the payment rights, even if there is no actual, constructive or record notice of that interest. This holding is also problematic because it opens the door to "shifting" collateral from one type to another merely by using some words rather than others in an agreement, which creates various priority issues and results in other uncertainties under the UCC. These two issues -- the possible first priority of an unknown prior interest in the payment rights under equipment leases and other chattel paper and the potential problems created by "shifting" collateral types -- are discussed in sections 4 and 5 of this letter. Possible resolutions to the problems raised by these issues are discussed in section 6 of this letter.

4. The Relative Priority of Payment Intangible Buyers vis à vis Chattel Paper Purchasers

The primary problem raised by the Case but left unaddressed is the relative priority between a buyer of payment intangibles that were created (*i.e.*, stripped) from chattel paper and a subsequent "purchaser" of the chattel paper (including a buyer of the chattel paper and a lender taking an interest in the chattel paper to secure a loan). Assuming the applicability of the court's holding that payment rights stripped from the underlying chattel paper from which they arise constitute payment intangibles, the key question seems to be whether the "super-priority" rules of Section 9-330(b) and (c) allow a subsequent purchaser of chattel paper to obtain priority in the proceeds of such chattel paper (*i.e.*, the payments received under the chattel paper) -- the same payments presumably embodied in the previously sold payment intangibles. The resolution of this question primarily requires an examination of the interplay among Sections 9-318, 9-322(c) and 9-330(b) and (c), which interplay the court expressly did not undertake to examine in the Case.[7]

There seems to be a great deal of support from scholars and practitioners who have reacted to the Case for the position that a subsequent perfected purchaser of chattel paper meeting the requirements of Section 9-330(b) (*e.g.*, new value, possession or control, good faith, ordinary course of business and no knowledge of violation) should have priority with respect to the payments arising under such chattel paper vis-à-vis a prior purchaser of payment intangibles stripped from such chattel paper. However, there is certainly some difference of opinion as to whether Article 9 clearly produces this result.

With respect to the hypothetical question posed above, there seem to be two main issues raised by Article 9 and the Official Comments thereto. First, an ambiguity seems to arise from a plain reading of Section 9-318(a), which provides that a "debtor that has sold . . . a payment intangible . . . does not retain a legal or equitable interest in the

[7] The court did discuss Section 9-330(b), but stated that "[w]e explicitly decline to resolve the ambiguity in Revised UCC Section 9-330(b) . . . ." We assume for purposes of this discussion that the sale of the payment intangibles stripped from the chattel paper was indeed a true sale so that the buyer receives the benefit of automatic perfection under Section 9-309 and that the subsequent purchaser of the chattel paper complied with the requirements of Section 9-330(b) to obtain "super-priority" over other perfected security interests in the chattel paper.

collateral sold." As others have noted, this could mean that once a seller sold stripped payment intangibles from chattel paper, the seller would retain no more interest in such payment intangibles to sell to anyone else (*i.e.*, the subsequent purchaser of the chattel paper from such a seller would be buying chattel paper devoid of any rights to payments). Section 9-318(b) does not change this result inasmuch as it affects solely buyers of accounts and chattel paper who have not perfected their interests in such receivables and does not apply to buyers of payment intangibles or promissory notes. Moreover, Official Comment 4 to Section 9-318 can be read to underscore this point with respect to sales of payment intangibles, which are automatically perfected under Section 9-309.[8]

The second issue centers around whether the super-priority rules of Section 9-330 (including as they relate to priority over proceeds of such chattel paper) apply to the hypothetical facts at issue here since Section 9-330 could be read to apply only to disputes among creditors with interests in chattel paper <u>as original collateral</u>. In the question at hand, since the interest of the first buyer, at least as determined by the court in the Case, is in payment intangibles and not chattel paper, it could be argued that the rules of Section 9-330 do not apply to determine the priorities as between these two parties.[9] It should certainly be noted that several commentators disagree with this interpretation. For example, Steven Weise has made the point that Sections 9-330(b) and (c) and 9-322(c) can (and should) be read to govern the kind of dispute at issue in the hypothetical question generated by the Case -- where one of the two parties is claiming an interest in the "stripped" payment intangibles only. That argument is predicated on a not unreasonable reading of Section 9-322 (reinforced by Official Comment 8 thereto) that if the chattel paper purchaser's security interest "*qualifies* for priority over a conflicting security interest under . . . Section 9-330," the chattel paper purchaser's security interest "also has priority over a conflicting security interest in . . . the proceeds of the collateral." The word "qualifies" means that there does not have to exist an actual conflicting security interest in the chattel paper. However, others have expressed concern that Sections 9-330 and 9-322 are ambiguous enough on this point that a court could conclude otherwise.[10]

5. <u>Problems Created by "Shifting" Collateral Types under the UCC</u>

The court's most controversial holding in the Case is premised on the notion that, for purposes of classifying the types of collateral involved in the financing transactions between Commercial Money Center and NetBank, once the payment streams have been "stripped" from the underlying equipment leases (which, as noted above, is accomplished merely by separately assigning, even in the same agreement, the payment streams and the underlying leases), the payment streams under the equipment leases are analytically

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[8] Official Comment 4 to Section 9-318 provides as follows: "If the security interest of a buyer of accounts or chattel paper is perfected, the usual result would take effect: transferees from and creditors of the seller could not acquire an interest in the sold accounts or chattel paper. The same result would occur if payment intangibles or promissory notes were sold, inasmuch as the buyer's security interest is automatically perfected under Section 9-309."

[9] As the court noted, "this special priority rule only applies by its terms to an interest 'in the chattel paper.' We have just held that the payment streams stripped from the leases are not chattel paper, so arguably this special priority rule is inapplicable." Case at 23.

[10] The summary of the issues in the paragraph were largely culled from a posting on the UCC ListServ by Robert Ihne.

severable from the equipment leases themselves. In the court's view, the leases constitute chattel paper because they are "records that 'evidence' a monetary obligation," but the payment streams do not constitute chattel paper because they "are not 'records' that 'evidence' monetary obligations, they are the monetary obligations." Having determined that the payment streams are a type of collateral distinct from chattel paper, the court ultimately determined the payment streams to be payment intangibles.

The problem with the analytical framework used by the court in the Case is that it moves Revised Article 9 somewhat off center. Now, instead of a unified set of perfection and priority rules that are well-designed and produce consistent results, we potentially have a system that creates different outcomes for essentially identical transactions, alters priority rules in unintended ways, introduces transactional risks that are not well-understood and creates uncertainty where formerly there was high degree of certainty.

Here is a sample of some of the difficult questions raised or unexpected results produced by the collateral classification holding and related analysis in the Case:

A. S sells all of S's rights in certain equipment leases to B, who neither files nor takes possession. B runs that risk that S can grant to a subsequent purchaser that files or takes possession a senior interest in the very same leases. However, if S "separately" (merely by using words of separate assignment, even if they appear in the same agreement) sells to B all of S's rights in the payments under the leases and all of S's other rights in the leases and if B neither files nor takes possession, then arguably under the holding of the Case, B has acquired a perfected security interest in the payment rights and an unperfected security interest in the other rights. Although B remains at risk with respect to the non-payment rights, B's interest in the payment rights (although not the subject of any filing) will trump the interest of a subsequent purchaser that acquires a security interest and perfects by filing and, because the payment rights are distinct from the leases themselves and (if separately assigned) do not constitute chattel paper, may even trump the interest of a subsequent purchaser that acquires a security interest and perfects by possession and otherwise meets the requirements for priority in chattel paper set forth in Section 9-330(b).

B. On Day 1, A sells all of its payment rights under certain equipment leases to B, who neither files nor takes possession. On Day 2, to secure an obligation, A grants a security interest in all of its rights under the leases to C, who immediately perfects by filing. The security agreement between A and C contains a negative pledge, which is set forth in all caps in C's filing. On Day 3, to secure an obligation, A grants a security interest in all of its rights under the leases to D, who takes possession. D meets all the requirements for priority under Section 9-330(b) with one exception: prior to entering into the transaction with A, D reviewed C's filing. Subsequently, A becomes insolvent and there is a priority contest among B, C and D. Assume for the moment that the court hearing the matter interprets Section 9-330(b) as implicitly granting A the power to transfer rights in the leases (including all payment and other rights thereunder) to a secured party. Assume further that the court agrees with the holding in the Case regarding the classification of collateral: if "stripped" (*i.e.*, separately assigned), the payment rights under the leases constitute payment intangibles. In the priority contest between B and C as to the payment rights under the leases, B wins under the first to file or perfect rule contained in Section 9-322(a)(1). In the priority contest between C and D as to the leases, D cannot rely on Section 9-330(b) to achieve priority over C (D was aware of the negative pledge), with the result that C wins under Section 9-322(a)(1). And in the priority contest between B and D as to the payment rights, it appears (as Steven Weise has argued) that D does have a security interest that qualifies for priority over a conflicting security interest under Section 9-330 and, therefore, D wins under Section 9-322(c)(2). In short, B trumps C, who trumps D, who trumps B. In light of this circular priority, how does the court rule?

C. S sells to B all of S's rights in certain promissory notes in a "servicing retained" transaction. Each of the notes is secured, pursuant to a related security agreement, by an interest in certain specified equipment. In one case, S absolutely assigns to B all of S's rights in a note and the related security agreement. In another case, S absolutely assigns to B, in separate clauses in the same agreement, all of S's rights in the payments due under a note as well as all of S's other rights in the note and the related security agreement. In each case, B neither files nor takes possession of the note or the related security agreement. Like the equipment leases in paragraph A above, each note, together with the related security agreement, constitutes tangible chattel paper. In the first case, B runs the risk of having its interest in the note and the related security agreement primed by a subsequent purchaser that meets the requirements of Section 9-330(b). In the second case, however, because the payment rights under the note are "stripped" (*i.e.*, separately assigned), the payment rights could, under the holding of the Case, be classified as payment intangibles. In that event, it appears that a subsequent purchaser who takes possession of the note and the related security agreement and otherwise meets the requirements of Section 9-330(b) would not be able to prime B's prior interest in the payment rights.

D. D sells to SP1 all of D's rights in the principal and interest payments and other fees, costs and charges (including any prepayment premium) under an unsecured non-negotiable promissory note and grants to SP1 a security interest in all of D's other rights in the note. SP1 neither files nor takes possession of the note. Later, D grants to SP2, as security for a loan, a security interest in all of D's rights in the note. As part of the loan transaction, SP2 takes possession of the note. Assume that SP2 otherwise meets the requirements for priority in instruments set forth in Section 9-330(d). Assume further that D becomes insolvent and there is a priority contest between SP1 and SP2 with respect to the payments under the note. SP2 argues that its interest in the note qualifies for priority under Section 9-330(d), that the payments under the note constitute proceeds of the note and that, as a result, SP2's interest in the payments primes SP1's interest in the payments. SP1 argues that the payment rights in the note are distinct from the note itself, the former being payment intangibles and the latter being an instrument (*i.e.*, a writing that evidences a right to the payment of a monetary obligation as opposed to the right to the payment of the monetary obligation itself). SP1 further argues that, having been "stripped," the payment rights in the note are not proceeds of the note (the note being merely the writing evidencing the payment rights as opposed to the payment rights themselves). If SP1's analysis is correct, Sections 9-330(d) and 9-322(c)(2) will not protect SP2. According to SP1, under Section 9-330(d) SP2 may be a qualified purchaser of the *writing* that evidences the payment rights, but SP2 is *not* a qualified purchaser of the payment rights evidenced by the writing. And even if SP2 is deemed to be a qualified purchaser of the note and all related rights (including payment rights) under Section 9-330(d), because D did not have rights or the power to transfer rights in the payment rights at the time of the loan transaction, SP2 does not have a *security interest* in the payment rights under the note (either as original collateral or as proceeds) and thereby fails to meet the stated requirements for priority set forth in Section 9-322(c)(2). Is it clear that SP1 is wrong? If requested, would a law firm that is experienced in UCC matters give an opinion to the effect that SP2's interest has priority over SP1's interest with respect to the payment rights?

E. S is the owner of a promissory note that is secured by an interest in certain specific goods. The security interest in the goods is created by a security agreement that is separate from the note. Pursuant to a written purchase and sale agreement, S absolutely assigns an undivided 10% interest in all of its rights in the note to B. In the purchase and sale agreement, S specifically reserves for itself the benefit of all security interests created by, and all enforcement and other rights arising under, the security agreement. Assume that B neither files nor takes possession of the note. By separately assigning an undivided 10% interest in the note without the benefit of any security, has S "stripped" a portion of the note from the chattel paper (the note and the security agreement taken together)? If so, is B's undivided 10% interest in the note automatically perfected under Section 9-309(4)?

We expect that there are other difficult questions raised or unexpected results produced by the collateral classification holding and related analysis in the Case.

6. <u>Suggested Resolutions</u>

Here are two (but by no means the only) possible resolutions that have been proposed by the UCC Committee to address the priority and other issues created by the holdings in the Case:

A. *To avoid "shifting collateral" problems, amend the UCC to provide explicitly that chattel paper and instruments include the related payment rights and make certain related changes.*

(1) Amend Section 9-102(a)(11) to provide that "chattel paper" includes the monetary obligations evidenced by the related record or records.

(2) Amend Section 9-102(a)(47) to provide that an "instrument" includes the right to the payment of a monetary obligation evidenced by the related negotiable instrument or other writing.

(3) Add a new provision stating that a separate assignment of the payment rights or other rights arising under chattel paper or an instrument (whether in the same security agreement and otherwise and however phrased) does not create a general intangible or other type of collateral but instead

constitutes an assignment of the chattel paper or instrument (as applicable). This provision might be added as a new subsection to Section 9-203.

(4) Make technical amendments either to Section 9-318(b) or to Section 9-322(c) so that it is clear that the interest of a subsequent purchaser of chattel paper or an instrument who takes possession and otherwise meets the requirements for priority set forth in Section 9-330(b) or (d) will also have priority in any payments arising under the chattel paper or instrument.

B. *Amend the UCC to provide that perfection in payment intangibles derived from chattel paper is not automatic and must be achieved by possession of the chattel paper or by filing.*

As the main concern with the holding in the Commercial Money Center case is the desire to protect a subsequent chattel paper purchaser against a "secret" prior true sale of the payment stream, proposal B is a simple one:

(1) Amend Section 9-309(3) to expressly exclude payment intangibles derived from (*i.e.*, stripped from) chattel paper.

This amendment would directly address the priority problem raised by the court's holding due to automatic perfection in a sold payment intangible derived from chattel paper. This amendment would also not hinder in any substantial way the stripping of payment streams from chattel paper because the buyer of the payment streams would be able to protect its interests by filing or taking possession of the chattel paper to perfect. The later purchaser of the chattel paper would be placed on notice by the filing or possession by the earlier buyer of the chattel paper.

(2) Amend Section 9-318(b) to add the following sentence: "For purposes of determining the rights of creditors of, and purchasers for value of chattel paper from, a debtor that has sold a payment intangible derived from such chattel paper, while the buyer's security interest is unperfected or perfected by filing, the debtor is deemed to have rights and title to the payment intangible identical to those the debtor sold."

This amendment would address the concerns raised by commentators that the later purchaser of the chattel paper -- even one that took possession -- would end up with an "empty shell" because the payment stream had been stripped out. A later purchaser of the chattel paper who takes possession should prevail not only against a prior buyer who is unperfected but also against a prior buyer who perfects by filing.

(3) Amend Section 9-330(b) by inserting "or in any payment intangible derived from the chattel paper" immediately after the second reference to "chattel paper" in that section.

This amendment (when coupled with the other two amendments) would clear up any ambiguity in Sections 9-330(b) and (c) and 9-322(c) that a subsequent purchaser of chattel paper who takes possession and otherwise meets the various conditions of Section 9-330(b) would have priority over the earlier buyer of the payment stream.

Should either proposal be adopted, we offer to recommend corresponding changes to the Official Comments that would need to be made.

* * *

In closing, we are submitting this letter in the interest of contributing to the lively discussion and debate regarding the ramifications of the Case. We have offered two proposals to resolve the real and significant impact that the Case will have on secured transactions. By limiting our proposed resolutions to the two set forth in this letter, we do not mean to imply that our resolutions are either exhaustive or complete. We may have other possible resolutions to propose at a future date, or, alternatively, we may opt to develop further those already proposed. In all cases, however, we wish to assist the PEB in its consideration of the Case and its resolution and wish to remain engaged in this process to the extent that the PEB deems helpful. To that end, if any portion of this letter seems unclear and requires further explanation, we will be happy to provide the same upon request.

Sincerely yours,

James S Coch

James S. Cochran
Co-Chair

Overview of Securitization, True Sale, and Payment Stripping

This Appendix 1 attempts to address the question of whether there is a business need or reason to "strip" and sell a payment and therefore create, or to re-characterize the lease receivable payments as, a sold "payment intangible" which is afforded automatic perfection under Section 9-309(3) when sold.[1]

1. Securitization

The court in the Case states that "[w]e are told that the multi-billion dollar securitization industry depends on being able to fractionalize financial assets, and specifically on stripping payment streams from underlying transactions such as the equipment leases in this case." (Case at 2.) This statement is an acknowledgement of the relative obscurity surrounding the securitization industry and process. The goal of securitization is, however, in its essence, relatively straightforward: it is the creation of publicly or privately offered (and traded) securities, typically in the form of commercial paper, notes or certificates, backed by the securitized receivables pool. As discussed below, whether a securitization is structured as loan or sale of a lease portfolio to a bankruptcy-remote "special purpose entity" ("SPE") or to a lender's commercial paper conduit, securitization is both relatively common and vital to the leasing industry, as the securitization industry provides a source of relatively low-cost liquidity[2] to a lessor's portfolio of lease assets, with the ability to raise additional investment capital from its lease portfolio and to redeploy that capital in new higher-yielding transactions, increasing the lessor's profit potential.

A. Special Purpose Entity

A securitization is essentially a two-step process. The issuance of the securities backed by the receivables is the second step. The first step of the process, in a "classic" lease pool securitization, is for a leasing company to "package" and transfer a portfolio of its lease transactions via a "true sale" of the receivables, the underlying leases and the leased equipment (collectively described as the "lease pool") to an SPE formed

[1] This question was raised by Donald J. Rapson on the UCC ListServ in his September 1, 2006 posting: "what exactly are the purported benefits of stripping the payment stream from the underlying chattel paper or promissory note?"

[2] Although the interest or certificate rate of the securities backed by the securitized lease pool is usually significantly lower than the lessor's borrowing rate, largely due to risk diversification and credit support, the lessor's true cost of the securitized sale or borrowing must include the significant transactional costs of the attorneys, accountants, and other professional or financial advisors engaged by the transaction parties as well as the costs of the surety bond and portfolio credit rating. These costs are typically borne by the lessor, and therefore, the "all-in" cost to the lessor is considerably higher than the interest or certificate rate of the asset-backed securities. Nonetheless, in many instances the all-in cost to the lessor is still less than the lessor's own borrowing rate, or lease portfolio sale value, without the securitization. Even if the all-in cost of the securitization is relatively high, the lessor may nevertheless be forced to securitize in order to raise additional investment capital due to a limited borrowing capacity arising from pre-existing high leverage ratios on its balance sheet.

specifically to take title to the lease pool, which SPE then issues securities backed by the lease pool.

B. Sale vs. Loan Securitization Structures

The possibility has been raised on the UCC ListServ that the Commercial Money Center transactions were not "true securitizations" as there was no SPE in the structure.[3] We believe the lack of an SPE is not relevant to the analysis. A securitization can be accomplished within a number of different structures. The complexities of the securitization process arise from the nuances of the transaction, which attempt to address legal, accounting, and credit issues. Securitization structures range from relatively complex "classic securitizations" (*i.e.*, "true sales" to an SPE formed to achieve bankruptcy remoteness) to rather straightforward loans made by a lender and secured by a prior perfected security interest in the borrower's lease portfolio, which loans are then transferred by the lender to its affiliated "commercial paper conduit" (*i.e.*, the lender's own SPE). In an alternative structure to a "true sale," the lessor/packager assigns the lease payments and grants a security interest in the remainder of the lease pool (*i.e.*, the other rights under the leases and the residual rights in the equipment) to a lender's captive commercial paper conduit, which commercial paper conduit acts to consolidate similar lease pools packaged and transferred from other leasing companies, with the goal of achieving economies of scale and risk reduction via portfolio diversification and ultimately issuing commercial paper backed by the lease receivables.[4]

C. Surety

In either the "true sale" or "loan" securitization scenario, depending on the credit quality of the portfolio, there may be a requirement or necessity for surety bonding to support the credit quality of the portfolio. As such, securitization structures typically provide for some form of surety, recourse, indemnity or other credit support to bolster the credit profile of the securitized pool and thus enhance the rating given by the rating agency (such as Moody's, S&P or Fitch) to the securities backed by the pool.[5] The goal of the "sponsor parties" (*e.g.*, the lessor or the lender) desire to achieve a sufficiently-enhanced credit rating on the portfolio to assure that the asset-backed securities to be issued by the SPE or commercial paper conduit are marketable.[6]

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[3] See Donald J. Rapson's posting on the UCC ListServ of October 12, 2006: "it has now been determined that this case did not involve a securitization. There was no Special Purpose Vehicle (SPV) in the structure of the transaction. Consequently, characterizations of this case as a 'classic securitization' are incorrect." This posting was responded to later the same day on the UCC ListServ by Tom McCurnin, who identified himself as one of the attorneys who worked on the Case and who indicated that, in approximately 25% of Commercial Money Center's lease pools, an SPE was used to securitize the pools.

[4] A further discussion of the reasons for utilizing the sale over the loan structure is provided below in this Appendix 1.

[5] Please see diagrams of the Commercial Money Center structure as well as of a "classic" securitization and alternative structures in Appendices 2 through 5 to this letter.

[6] Thus, for many pools of lease assets (particularly pools that are of "sub-prime" credit quality, as in the Case), a surety is essential to the issuance of securities backed by the pools as the surety assures, to the satisfaction of the rating agencies rating the transaction and for the benefit of the future holders of the

2. True Sale

The first-step of the securitization mentioned above, the packaging and transfer of the lease portfolio to the SPE or commercial paper conduit, typically requires some closer analysis as the securitization structure can exist anywhere in a continuum that runs from transactions that are clearly structured and intended as debt to transactions that are clearly structured and intended as sales.

As for Commercial Money Center's securitization structure, it appears from the facts provided in this case that the debtor/seller of the lease portfolio, Commercial Money Center, and the secured party/purchaser, NetBank, desired to achieve a "true sale" securitization structure. Notwithstanding the parties' stated intentions, it also evident from the economic substance of the transaction (*e.g.*, the reversionary interest of Commercial Money Center in the payment stream, the guaranteed minimum payments, the indemnity contract and the substantial continuing servicing obligations) -- and, as noted in section 2 of the letter, the court held -- that the transaction had more of the risk allocation and economic substance of a loan than of a sale.

In answer to a question posed on the UCC ListServ, there is a credible *business* explanation as to why Commercial Money Center might have desired to "strip the payment stream from the leases."[7] A "true sale" of the lease portfolio would have allowed Commercial Money Center to accomplish two business goals which could not be achieved via a "loan" securtization structure. Those two goals, which are briefly discussed below, are (i) off-balance sheet "sale" treatment and (ii) immediate recognition of income.

Off-Balance Sheet "Sale" Treatment: The seller receives off-balance sheet treatment, meaning that the leases and the related equipment are no longer assets on the lessor/seller's balance sheet and that the corresponding "securitized loan" (which has been re-characterized as a sale) is no longer a liability on its balance sheet. This considerably "cleans-up" the balance sheet of the lessor/seller and can be a significant benefit, particularly for a smaller leasing company with limited equity capital resources, and which must turn to debt capital to acquire its lease portfolios. A lessor/seller with a very high debt-to-equity ratio has fewer financing options because lenders are increasingly reluctant to lend to such a lessor. In that case, the sale of the lease assets increases the equity capital and net worth of the lessor, making the lessor's balance sheet view more attractive to lenders.

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securities, that there is a relatively guaranteed fixed stream of payment receivables, eliminating much of the risk of underlying lessee credit defaults. If this risk were not greatly reduced, the issuance of securities backed by the pools would be hindered as the securities would be difficult to evaluate by the financial markets. On the other hand, a relatively guaranteed fixed stream of payments is easily valued by the financial markets as an annuity, by discounting to present value the expected payment stream using an appropriate credit-risk-adjusted discount rate (which the applicable rating agencies' ratings effectively will pre-determine as such discount rate will largely be based upon their ratings).

[7] See Donald J. Rapson's September 29, 2006 posting on the UCC ListServ and footnote 1 above in this Appendix 1.

Immediate Recognition of Income: The seller achieves immediate "gain on sale" income recognition of the securitized portfolio payment stream sale proceeds, in contrast to a loan where the principal amount of the loan would be retained as a liability on the lessor's balance sheet, and the income (the difference between the principal and interest payments and the rental income) would be amortized over the life of the loan. Without "true sale" treatment, the borrower would have to recognize the income from the transfer of the portfolio to the lender over the life of the portfolio, which might range from 24 to 36 months for a high-tech lease portfolio, from 48 to 60 months for most generalized equipment, and from 72 months to 84 months (or higher) for longer-life lease assets.

3. Payment Stripping

Less common, but still within the scope of securitization structures in the leasing world (and as attempted by Commercial Money Center), is for a lessor to structure a sale transaction in which only the lease payments, and not the underlying leases or equipment, are sold (*i.e.*, a "stripping"). A true sale of a payment stream only, if properly structured, would allow the seller to accomplish two important business goals in addition to immediate income recognition and off-balance sheet financing: (i) retention of residual value interest in the underlying leases and equipment; and (ii) the ability to depreciate the leased equipment for tax purposes (*i.e.*, to utilize the depreciation deductions and other capital allowance benefits under the Internal Revenue Code).

Retention of Residual Value Interest: "Stripping" the lease payments allows the lessor to obtain the benefits noted above under sale treatment, yet retain ownership of the leases and the underlying equipment, an important profit component for the lessor. In true "fair market value" leases, the value of this residual interest could be considerable and could represent substantially all, if not all, of the profit in the transaction for the seller.[8] In a "lease intended as security," the residual interest retention would not represent as much of a profit potential, but it could still be significant, even with 10% "puts" or bargain purchase options (as appears from the UCC ListServ was the structure of the Commercial Money Center lease pools).[11]

Ability to Retain Tax and Accounting Benefits: The retention by a lessor of the ability to depreciate the equipment for tax purposes is of considerable value to a true "fair market value" lessor (a lessor under a lease with a "fair market value" purchase option, which would likely entitle the lessor to claim tax benefits under the Internal Revenue Code). As the Commercial Money Center leases appear to have been disguised financings with 10% purchase options, Commercial Money Center would not likely have been able to take the tax benefits available to owners of capital equipment. However, the

[8] It is noted that the retention of the residual value in the equipment is one of the more favorable aspects to the lessor of the "loan" (as opposed to the "true sale") securitization structure. In a "loan" structure, the rights to the equipment remain with the lessor (albeit subject to the lender's security interest). By contrast, in a "true sale" structure the lessor relinquishes its interest in the equipment – unless, of course, the lessor structures the transaction as a sale of the "stripped" portfolio lease payments only, in which case the lessor will retain its ownership interest in the equipment and the associated tax and accounting benefits.

[11] See Thomas McCurnin's posting of October 18, 2006.

ability to take tax allowances or credits, such as under the Modified Accelerated Capital Recovery System, or investment tax credits, and any other available capital equipment investment tax benefits, would be a clear benefit to other leasing companies, particularly where profits margins are thin. An additional benefit to a lessor/seller who retains legal title to the underlying leased equipment assets is to allow the lessor/seller to depreciate the equipment for book purposes. This benefits the lessor's balance sheet by allowing the lessor to continue to reflect an asset (the equipment's residual value) on the lessor's balance sheet, strengthening the balance sheet and making (among other benefits) lenders more likely to extend credit to the lessor.

Consequently, the four goals described above in parts 2 and 3 of this Appendix 1 (*i.e.*, off-balance sheet treatment, immediate recognition of income, retention of residual value interest, and the ability to receive certain tax and accounting benefits) are achievable simultaneously only by structuring a transaction as a "true sale" of the payment stream ***alone*** (*i.e.*, by "stripping") without a corresponding sale of the underlying chattel paper or leased equipment.[12] It bears repeating, however, that the

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[12] In the Case, the court's legal conclusion that payment intangibles had been created rested on its factual finding that the lease payments had been "stripped" from the leases themselves. According to the court, pursuant to each Sale and Servicing Agreement between Commercial Money Center and NetBank ("SSA"), Commercial Money Center assigned "its contractual rights to future lease payments" and "its rights under the surety bonds" to NetBank. (Case at 2-3.) In addition, "as security for NetBank's receipt of the lease payments and any surety bond payments, [Commercial Money Center] granted NetBank a security interest in the underlying leases and other property." (Case at 3.) In other words, stated the court, Commercial Money Center "assigned NetBank both an interest in the payment streams and an interest in the underlying leases, but it separated the two interests." (Case at 3.) From the simple fact of "separation" (accomplished merely by the particular wording used in the SSA), the court went on to conclude that the lease payments were neither chattel paper nor accounts and, for that reason, necessarily fell "within the payment intangible subset of the catch-all definition of general intangibles." (Case at 15-16.) Although the court acknowledged that a payment intangible is, as defined under Section 9-102, a general intangible under which the account debtor's principal obligation is a monetary obligation, the court did not undertake any analysis whatsoever of the lessee's obligations under the leases (whether under the payment provisions of the leases or otherwise). (See Case at 16.) If the court had done so, the court might have concluded that the lessees had numerous material obligations under the leases in addition to the payment obligations and that these additional obligations could not be separated from the payment obligations or treated as secondary obligations in comparison to the payment obligations by the mere use of some words rather than others in the SSA. For example, the leases that were the subject of the Case were likely "triple-net, hell-or-high-water" leases (*i.e.*, "finance leases" under Article 2A) under which the lessor contractually delegated to the lessee essentially all of the risks, obligations and responsibilities which typically reside with an owner of equipment. These risks, obligations and responsibilities, which derive from the equipment or from its possession and use, include, among others, those related to (1) loss and liability, (2) maintenance, performance and condition, and (3) fees, charges, taxes and assessments. In short, the court might have concluded that, despite the attempted "separation" of the payment rights from the other rights under the leases, the lessees' obligations to make payments under the leases were inescapably and unavoidably intermingled with the lessees' other material obligations under the leases, which would make it impossible to isolate the lessees' payment obligations from their other obligations and then characterize the payment obligations as the "principal" obligation in a set of obligations that, merely as a result of the words used in the SSA, was designed to exclude all non-payment obligations (Case at 3 and 4). If the court had engaged in a fuller analysis such as that described above in this footnote, it is very possible that the court would have avoided the simple (and, some would argue, simplistic) legal conclusion that the mere use of particular granting words in the SSA were sufficient to transmute the payment rights under the lease chattel paper into payment intangibles as defined in Section 9-102.

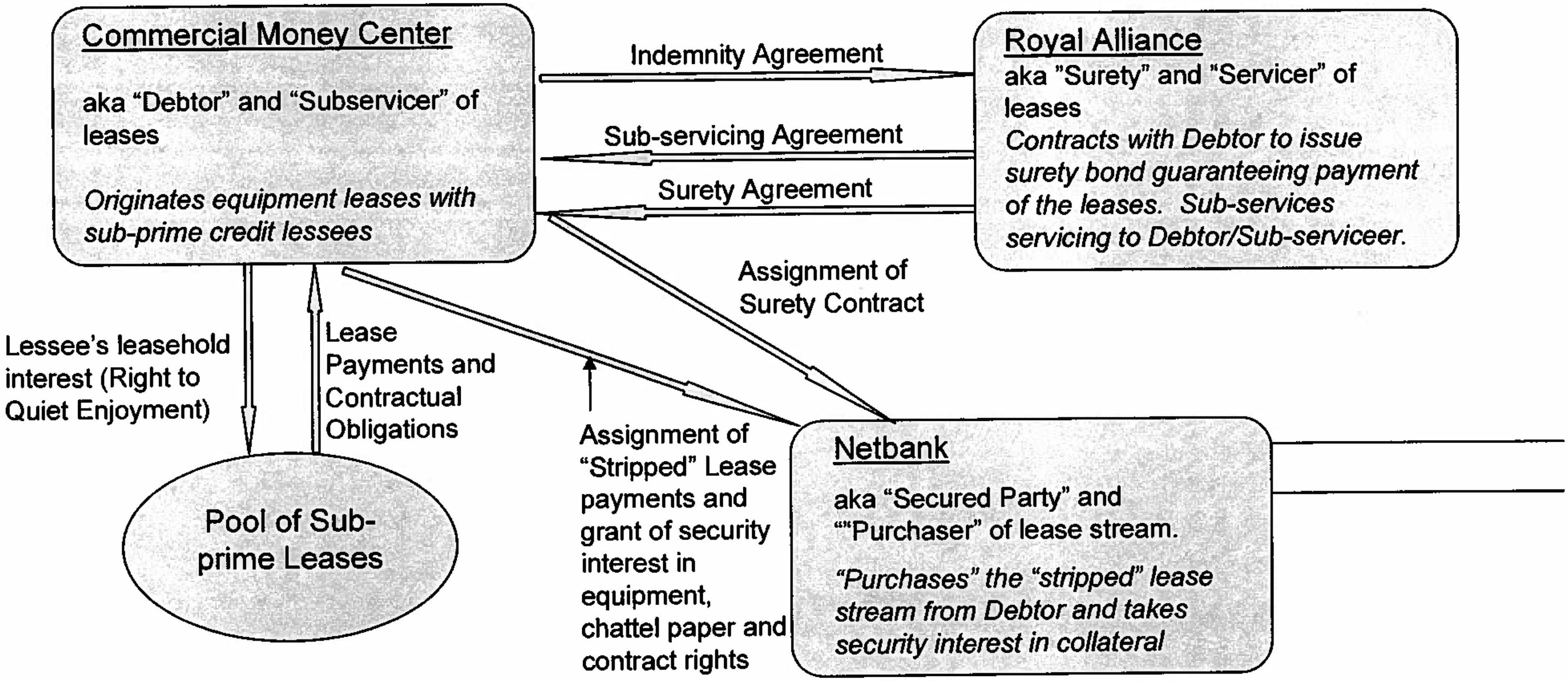
"stripping" of payments is not necessary to achieve the goal of securitization, which is simply the ability to "securitize" the portfolio assets in order to achieve liquidity at a lower borrowing rate.

In conclusion, although there is a *"business need"* to sell stripped lease payments in order to obtain favorable accounting and tax treatment, and retain profit potential, there is no need to treat these various structures differently from the sale of, or loan secured by, the underlying chattel paper under Article 9. The filing of a UCC-1 financing statement, or possession of the chattel paper, is, in our experience, an almost universal practice in these transactions, and we believe that the securitization industry would not be greatly inconvenienced by making this a requirement for perfection in "stripped payment" securitization transactions, as suggested in the body of this letter. In fact, the securitization industry would likely be greatly relieved by the certainty of a required UCC-1 financing statement filing, or possession of the underlying collateral, to assure perfection and relative priority in stripped payments and other interests transferred under chattel paper.

Commercial Money Center Case

Appendix 2

Case Parties Diagram



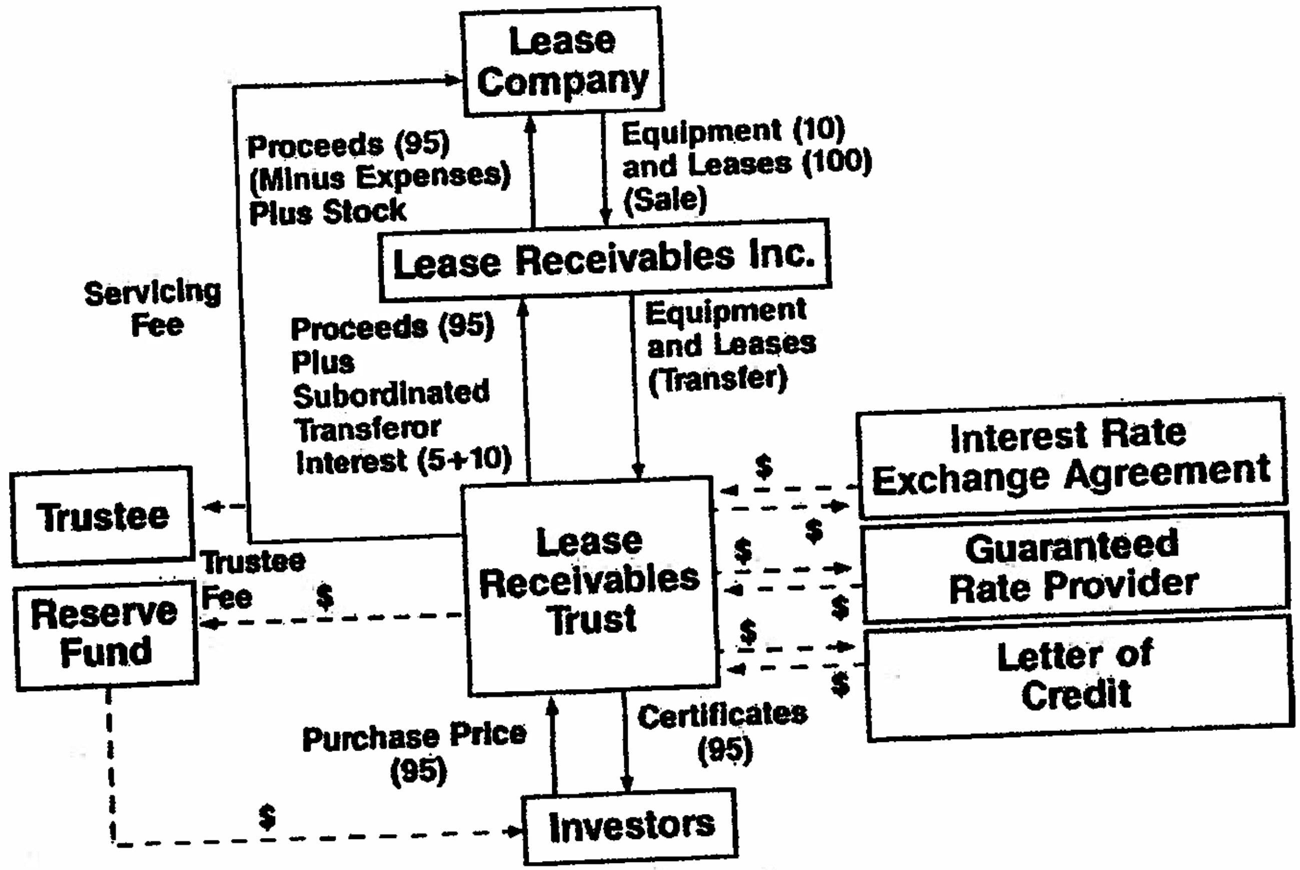
Issue #1: Is the payment stream chattel paper (section 9102 (a) (11)) or a general intangible (section 9102 (a) (42) and (61))
Held: general intangible, namely a payment intangible

Issue #2: Is the assignment a sale or a security interest? If a sale (and a payment intangible), then the transaction is automatically perfected (section 9309 (3)); if a security interest, need to file or possess (there was no filing)
Held: a security interest

Issue #3: Did Debtor retain possession leases? If so, the security interest is unperfected and falls to the strong-arm challenge of the bankruptcy trustee
Held: Remand for factual determination

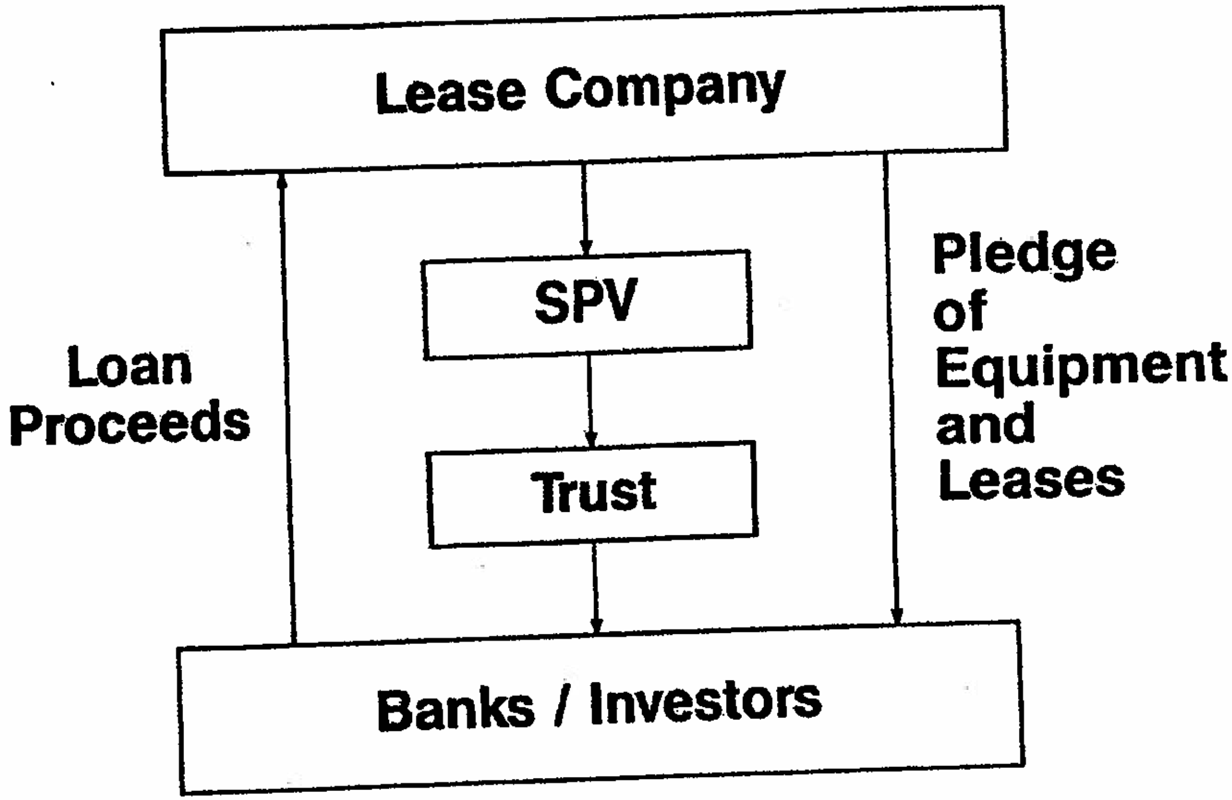
E49007.IMG 02/07/92:es

LEASE SECURITIZATION FINANCING



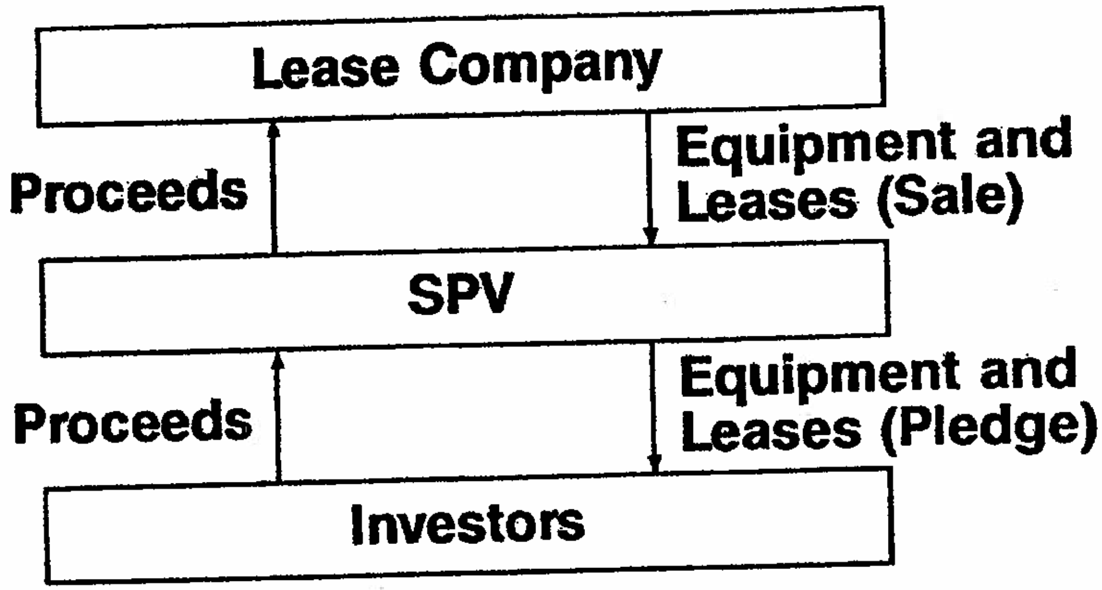
Appendix 4

TRADITIONAL SECURED FINANCING



Appendix 5

ISOLATE ASSETS



- True Sale
- Nonconsolidation
- Bankruptcy Remote

IACA
International Association of Commercial Administrators

December 11, 2007

RE; PROPOSED ARTICLE 9 STATUTORY CHANGES TO THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

To the Permanent Editorial Board for the Uniform Commercial Code,

On behalf of the International Association of Commercial Administrators (IACA), I would like to thank you for your prompt attention to the IACA proposed Article 9 statutory changes. We have reviewed your responses to the task force recommendations, as provided from the PEB meeting on September 27, 2007. Attached, please find the final version of IACA's proposed Article 9 statutory changes to the National Conference of Commissioners on Uniform State Laws (NCCUSL).

William Henning has informed IACA that the Permanent Editorial Board (PEB) is planning to undertake a broad study of the inconsistencies that have emerged since the original adoption of Revised Article 9. IACA was also advised that the PEB would prefer to make the IACA requests part of a broader package of revisions that results from the study. I would strongly recommend that IACA's four (4) proposed changes be considered immediately. These four (4) inconsistencies are detrimental to the accuracy of the public record maintained by a filing office and time is of the essence. Any additional delay will only lead to greater inaccuracy. Since the PEB has been quite responsive to our draft proposals in the past months, I trust we may expedite a resolution.

Finally, many of the IACA member jurisdictions have already passed their legislative sessions for this year. In order to allow for greater uniformity, the IACA Secured Transaction Section plans to present these proposed changes to its membership at the next annual meeting, in May 2008, in Salt Lake City, Utah. This will afford our membership sufficient time to present the changes to their respective legislative bodies, thereby allowing the IACA membership to implement the changes at relatively the same time.

Let us know if we may be of additional assistance and please notify us as this progresses.

Thank you,

Kelly L. Kopyt, Esq.
Secured Transaction Section Chair
International Association of Commercial Administrators

International Association of Commercial Administrators (IACA) Proposed Article 9 Statutory Changes to the National Conference of Commissioners on Uniform State Laws (NCCUSL)

December 11, 2007

1. **"Public Record" Definition**: This proposed revision intends to clarify the application of existing law. A public organic record is a record that is filed to form, organize, incorporate, or otherwise create an organization. If the organization is organized solely under the law of one state or the United States, it is a "registered organization" under this act. The term includes any amendments to or restatements of the original record that are filed publicly. The term includes the articles of incorporation of a business corporation, the articles of incorporation of a nonprofit corporation, a certificate of limited partnership, and a certificate of organization of a limited liability company. In those states where a record must be filed for another type of entity, such as a business trust or a cooperative, to come into existence, the record will constitute a public organic record and the entity will be a registered organization. The record must also be available to the public for inspection or copying.

   Amend Section 9-102(a)(70): "Registered organization" means an organization (i) organized solely under the law of one State or the United States, and (ii) created by the filing of a public organic record with a governmental unit of the State or the United States.

   Add 9-102(a)(67)(A): "Public organic record" means a record that is (i) filed with a State or the United States to create an organization, (ii) shows that the organization has been created, and (iii) is available to the public for inspection or copying. The term includes an amendment to or restatement of the record that is filed with the State or the United States and available to the public for inspection or copying.

   Amend 9-503(a)(1): if the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on its public organic record;

2. **Claim Concerning Inaccurate or Wrongfully Filed Record (Correction Statements):** This proposed amendment intends to provide the filer, debtor and secured party with the ability to file a correction statement with respect an indexed record. IACA would like to keep the section title as "Claim Concerning Inaccurate or Wrongfully Filed Record" so as to avoid an unnecessary revision of the associated form.

   Amend 9-518(a): (a) A person may file in the filing office a correction statement with respect to a record indexed there if:

   (1) the person believes that the record is inaccurate or was wrongfully filed, and
   (2) one or more of the following applies:
      (i) the record is indexed under the person's name;

(ii) the person would have been entitled to file the record pursuant to Section 9-509; or
(iii) the person filed the record.

3. **<u>Transmitting Utility Financing Statements:</u>** If a debtor is a transmitting utility that did not indicate as such on the initial financing statement, the standard lapse period would be applied by the filing office. Section 9-515(f) provides that the transmitting utility debtor may indicate its status on a "financing statement," however, due to system limitations, filing offices are unable to change the lapse period when a financing statement amendment is filed. The correct lapse period must be indicated on the initial financing statement only.

   <u>Amend 9-515(f):</u> Transmitting Utility Initial Financing Statement. If a debtor is a transmitting utility and a filed initial financing statement so indicates, the initial financing statement is effective until a termination statement is filed.

4. **<u>Uniform Form of Written Financing Statement and Amendment:</u>** Approved UCC forms have become increasingly inconsistent from one jurisdiction to the next. Many jurisdictions now require the use of a form quite different form that presented in Article 9. In order to encourage use of a standard form, IACA requests that the model forms be removed from 9-521 and reference be made to the IACA Recommended UCC Forms. IACA is diligent in revising its IACA Recommended UCC Forms and we are confident that we can encourage uniformity in the jurisdictions where such legislative delegation is lawful. Additionally, removal of the model form will encourage routine review and revision, when necessary.

   <u>Amend 9-521:</u> Uniform Form of Written Financing Statement and Amendment.

   (a) **Initial Financing Statement Form.** A filing office that accepts written records may not refuse to accept a written record in a form approved by the office [,nor may it refuse to accept a written record in the most recent form approved for nationwide use by the International Association of Commercial Administrators], except for a reason set forth in Section 9-516(b).

   (b) **Amendment Form.** A filing office that accepts written records may not refuse to accept a written record in a form approved by the office [,nor may it refuse to accept a written record in the most recent form approved for nationwide use by the International Association of Commercial Administrators], except for a reason set forth in Section 9-516(b).

MEMORANDUM

FROM: Uniform Commercial Code Committee of the Business Law Section of the State Bar of California (the "Committee" or the "UCC Committee")

DATE: May 1, 2008

RE: Analysis of International Association of Commercial Administrators ("IACA") Proposed Changes to UCC Article 9

The Committee has analyzed the proposed changes to Uniform Commercial Code (the "UCC") Article 9 proposed by IACA in a communication to the Permanent Editorial Board for the Uniform Commercial Code (the "PEB").[1] This memorandum may be modified to reflect the results of further research and analysis by the Committee. Please note that the positions set forth in this memorandum are those of the Committee only. They have not been adopted by the Business Law Section or its overall membership, or by the State Bar's Board of Governors or its overall membership and are not to be construed as the position of the State Bar of California. Membership on the Committee and in the Business Law Section is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources

A. Guiding Principles and Criteria Applicable Generally to Analysis of Proposed Amendments to the UCC

The analysis of any proposed amendments to the UCC should be guided by the overarching principles of: (A) preserving the uniformity of the UCC, and (B) maintaining the coherence of the UCC and consistency with the underlying purposes and policies of the UCC. Consequently, proposed amendments to the UCC should be analyzed based on the following specific criteria to determine whether the proposed amendments are (1) necessary, (2) appropriate, (3) comprehensive, and (4) uniform.

The first of these criteria, necessity, requires that there be a defect in the current text of the UCC that causes a problem in practice that can be solved by a change in the text. For example, where text has been subject to conflicting interpretations that have generated significant legal disputes or legitimate uncertainty causing significant cost or distortion of transactions, or have led to a result that is contrary to the underlying polices or purposes of the UCC, a change may be necessary. Attempts to "improve" on or "tinker" with the language of the UCC ("we can say it better"), where no serious need for a change has been demonstrated, or where there is no clear evidence that a real, rather than an imagined, problem exists under the current UCC text, should be resisted; attempts to make such changes raise the risk of unintended consequences and needlessly imperil uniformity due to the possibility that they will

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[1] Specifically, this memo refers to the proposed changes indicated in the document entitled "International Association of Commercial Administrators (IACA) Proposed Article 9 Statutory Changes to the National Conference of Commissioners on Uniform State Laws (NCCUSL) December 11, 2007" under cover of a letter from Kelly L. Kopyt, Secured Transactions Section Chair, International Association of Commercial Administrators dated December 11, 2007, addressed to the Permanent Editorial Board for the Uniform Commercial Code. A copy of the IACA letter and proposals are attached to this memorandum.

not be universally adopted. Even when it is arguable that the UCC might be improved by a particular amendment, an amendment is generally not advisable if the UCC, in its current form, will achieve the correct result. Changes should not be made to address problems that are the result not of a defect in the current text but of a mistake on the part of a person that failed to comply with the current text, unless the evidence suggests that a significant number of similar mistakes are being made, or are likely to be made, that can be attributed to ambiguous or confusing text.

The second criterion, appropriateness, requires that the amendment be directly targeted at correcting the problematic provisions in the UCC text. This requires precise identification of the problem and extensive and careful analysis of all of the options available to address the defect in the UCC text, and selection of the best solution among these options. The proposed correction for the defect should be complete and not incremental, and the costs, benefits, and burdens of the proposed change to all parties affected should be identified and taken into account. Furthermore, the language of the proposed amendment should be carefully tailored to address the identified defect and avoid unintended collateral effects. Finally, the proposed amendment should be in harmony with and fully integrated within the current UCC text.

The third criterion is comprehensiveness. As it is not feasible to engage in frequent legislative efforts on a nationwide level and frequent change may well result in instability, proposed amendments should, absent emergency, be gathered into a single comprehensive legislative package rather than being introduced individually or in small bundles. Thus, it must always be considered whether a particular amendment, even if meritorious, can be combined with other proposed amendments in a comprehensive legislative package to be presented simultaneously to all states. A comprehensive approach to UCC amendments makes it more likely that such amendments will be fully integrated with each other and with the remainder of the UCC text and will be consistent with the purposes and policies underlying the UCC. Only in exceptional cases, when evidence of serious and imminent actual or potential harm establishes an urgent need for immediate action, should the need for a particular amendment outweigh the importance of acting with due deliberation to propose a comprehensive package of amendments.

A comprehensive package of proposed amendments is more likely to draw the attention, study and input of a far wider constituency, enhancing both the likelihood of quality and the greater likelihood of acceptance, i.e., simultaneous and uniform enactment, producing satisfaction of the fourth criterion, uniformity. A lack of uniformity among the versions of the UCC adopted by the various states leads to increased transaction costs, the potential for costly errors and unintended consequences. Although uniformity can never be guaranteed, a proposed UCC amendment not aimed at solving a unique local problem should not be enacted by a state unless there is evidence that it enjoys sufficient widespread support to make likely nationwide enactment. An endeavor to seek approval of a particular amendment on an ad-hoc state-by-state basis, without a substantial organizational effort on a national level, would be ill-advised and would likely jeopardize the essential uniformity of the UCC.

The best possible text of the proposed amendments, meeting the foregoing criteria and having the best chance of nationwide uniform enactment, is most likely to be achieved through a vetting of the proposed amendments by the co-sponsors of the UCC--the National Conference of Commissioners on Uniform State Laws and the American Law Institute—supported by the American Bar Association and state bar UCC committees around the country.

B. Summary of Conclusions and Recommendations with respect to the IACA Proposals

Of the four changes proposed by IACA, only one directly affects the performance of the duties of the Article 9 filing offices. This is the proposed amendment discussed in Section I, under the heading of "Transmitting Utility Financing Statements." The UCC Committee fully supports both the goal and the approach of this proposed amendment, for the reasons set forth below, but subject to satisfaction of the above-described "comprehensiveness" and "uniformity" criteria. Although, as explained below, the right result can certainly be reached under the current text, and the "problem" sought to be addressed, which arises in a very small number of instances, results not from a defect in the current text but only from a failure by a filing party to follow the guidance of the current text, in the context of a comprehensive package of amendments, clarification of the text by the proposed amendment can reasonably be considered useful to assure that filing offices are not forced to incur significant expense and disruption in order to compensate for such failure by a filing party.

With respect to the IACA proposal to amend the UCC provisions relating to entity debtor names (Section II – "'Public Organic Record' Definition"), the UCC Committee supports, again subject to the criteria of comprehensiveness and uniformity, the goal of the IACA proposal, but with some modification of the text of the proposed amendment. We note that this proposed amendment does not relate to the performance of the duties of the Article 9 filing office but rather is an effort to produce greater clarity, and thus certainty, for parties by assisting in the determination of the "correct" name of a debtor that is a registered organization. Again, the right result can certainly be reached under the current text of the Code, and thus the current text is not defective, but we agree that greater certainty might be achieved by modification of the text.

With respect to the two remaining IACA proposals (Section II – "Correction Statements", and Section IV – "Safe Harbor Forms"), the Committee has concluded that the proposed amendments are unnecessary and undesirable. The alleged defects or problems sought to be addressed by these proposals do not result from the current UCC text. Indeed, the proposals would alter the purposes and policies underlying the current text. Neither amendment is necessary for the proper performance of the duties of Article 9 filing offices.

C. Discussion of Proposals and UCC Committee Recommendations

I. Transmitting Utility Financing Statements (IACA Proposal #3)

CURRENT LAW

UCC Section 9-515(f) provides:

> **9-515 (Duration and effectiveness of financing statements; effect of lapsed financing statement):**
>
> **(f)** If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

IACA PROPOSAL

IACA's proposal would amend UCC Section 9-515 (f) to read as follows:

9-515(f) If a debtor is a transmitting utility and a filed initial financing statement so indicates, the initial financing statement is effective until a termination statement is filed.

DISCUSSION

A filed financing statement is normally effective for a period of five years after the date of filing. UCC Section 9-515(a). If a continuation statement[2] is timely filed, the effectiveness of the initial financing statement continues for an additional five years. UCC Section 9-515(e).

However, the effectiveness of a financing statement filed against a transmitting utility continues until a termination statement is filed; no continuation statement is necessary, provided that the debtor's status as a transmitting utility is indicated on the financing statement. The indication that the debtor is a transmitting utility is made by checking box 18 of the financing statement. See UCC Section 9-521.

Filing office procedures (and computer programs) are organized to determine, at the time of the filing of the initial financing statement, whether a financing statement is or is not given a five-year lapse date. In order to efficiently make that determination, filing offices must not be forced to make a visual examination of the entire "document" but instead only to ascertain whether there is a check in box 18. Electronic filing processes, in those states that offer this service, produce the same result by means of an equivalent technique. Thus, filing office procedures and programs, for both paper and electronic filings, are set up to make the perpetual term (no lapse date) determination only once, at the outset. Once the filing is assigned a five-year lapse date, an assignment made at the time of the filing of the initial financing statement, typically made by a computer program, filing offices are not set up subsequently to modify that lapse date assignment. This operational arrangement is likely what is meant by the statement in the IACA proposal that "due to technical reasons, filing offices cannot subsequently amend a transmitting utility financing statement to change the five year lapse period to the indefinite lapse period permitted with respect to transmitting utilities." Amendments other than continuations are designed to modify the "content" of the initial filing, i.e., information concerning parties or collateral, but are not designed to modify the duration of effectiveness. The underlying policy of facilitating the efficient operation of the filing office (including avoiding the need for visual examination by a staff person of each filing) certainly would militate against an imposition on the filing office of a duty to visually examine the content of each amendment to look for a change that would produce a modification of the duration of effectiveness that had already been established at the time of the filing of the initial financing statement. This policy is clear and the current UCC text is not inconsistent with this policy. Thus, the current text does not mandate an incorrect result.

The problem sought to be addressed by the IACA proposal results not from a defect in the current text but instead from a filer's attempt to avoid the consequences of its failure to check box 18 on the initial financing statement. In an attempt subsequently to correct that failure, some secured parties have sought to file amendments indicating in narrative form that the debtor is a transmitting utility. The amendment form does not contain a box to check to indicate that the debtor is a transmitting utility. See UCC Section 9-521.

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[2] The references here and below to a "continuation statement" or "termination statement" are (for purposes of visualization) to the UCC financing statement amendment form found in Section 9-521(b) with box 3 or box 2, respectively, checked on that form.

Under UCC Section 9-102(39), a financing statement means "a record or records composed of an initial financing statement and any filed record relating to the initial financing statement." A literal reading of that definition might appear to support the argument that a secured party could indicate the debtor's status as a transmitting utility on an amendment and thereby achieve indefinite lapse status. That was, however, not the intent of the drafters and would produce a result inconsistent with the policy of efficient operation of the filing offices; and such a reading would require filing offices to modify their existing intake practices with respect to amendments and to modify their existing computer programs. Moreover, reading that definition as absolute and applicable even when such a reading would produce inefficient, costly and otherwise undesirable results fails to take into account the introductory language of UCC Section 1-201(a), applicable to all definitions, "unless the context otherwise requires, ..."

The proper course of action to be taken by filers that fail properly to indicate a debtor's transmitting utility status on the initial financing statement is to file periodic continuation statements or, in the alternative, file a termination statement and a new initial financing statement indicating the debtor's status (a viable alternative only if there were no financing statements filed by other secured parties prior to the filing of such a new initial financing statement), as well as to better train and better supervise (or seek malpractice remedies against) those to whom they entrust preparation of their filings. This allocates the burden of remedying the error to the one that made the error, rather than onto the filing office.

A court considering the meaning of current text can and should reach the result indicated here. [3] However, the clarification provided by the proposed amendment is certainly an improvement and does not appear to present new problems. Indeed, it would bring Section 9-515(f) [brought forward essentially unchanged from the text of former Section 9-403(6)] into better alignment with Section 9-515(b), which expressly states the rule, previously only implied in former Section 9-403(6), that only an "initial" financing statement that states applicability of a longer duration is effective to achieve a duration beyond the general five-year period.

The Committee also suggests that, in connection with the foregoing amendment, consideration be given to whether any other amendments relating to transmitting utilities are necessary and desirable, so that the entire subject matter is dealt with at one time.

UCC COMMITTEE RECOMMENDATION

As indicated above, the UCC Committee endorses this IACA proposal. Lenders to transmitting utilities can avoid any prejudice or inconvenience simply by properly indicating the debtor's status as a transmitting utility on the initial financing statement. Any amendment should be accompanied by an Official Comment stating clearly that no substantive change in the governing rule is intended.

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[3] It is important to stress this point because there can be no assurance that a clarifying amendment will be enacted in all jurisdictions.

II. "Public Organic Record" Definition (IACA Proposal #1)

CURRENT LAW

Relevant portions of the current Uniform Commercial Code Sections 9-102(a)(70) and 9-503(a)(1) read as follows:

9-102 (Definitions and index of definitions):

(a)(70): "Registered organization" means an organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to have been organized.

9-503 (Name of debtor and secured party):

(a) A financing statement sufficiently provides the name of the debtor only if it does so in accordance with the following rules:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized.

IACA PROPOSAL

IACA's proposal would amend UCC Sections 9-102(a)(70) and 9-503(a)(1), and add 9-102(a)(67)(A), to read as follows:

9-102(a)(70) "Registered organization" means an organization (i) organized solely under the law of ~~a single~~one ~~s~~State or the United States, and (ii) created by the filing of a public organic record with a governmental unit of~~as to which~~ the ~~s~~State or the United States~~ must maintain a public record showing the organization to have been organized~~.

9-102(a)(67)(A) "Public organic record" means a record that is (i) filed with a State or the United States to create an organization, (ii) shows that the organization has been created, and (iii) is available to the public for inspection or copying. The term includes an amendment to or restatement of the record that is filed with the State or the United States and available to the public for inspection or copying.

9-503(a)(1)(a) A financing statement sufficiently provides the name of the debtor only if it does so in accordance with the following rules:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public organic record~~ of the debtor's jurisdiction of organization which shows the debtor to have been organized~~."

DISCUSSION

IACA explains the purpose of these proposed amendments as follows:

> "This proposed revision intends to clarify the application of existing law. A public organic record is a record that is filed to form, organize, incorporate, or otherwise create an organization. If the organization is organized solely under the law of one state or the United States, it is a "registered organization" under this act. The term includes any amendments to or restatements of the original record that are filed publicly. The term includes the articles of incorporation of a business corporation, the articles of incorporation of a nonprofit corporation, a certificate of limited partnership, and a certificate of organization of a limited liability company. In those states where a record must be filed for another type of entity, such as a business trust or a cooperative, to come into existence, the record will constitute a public organic record and the entity will be a registered organization. The record must also be available to the public for inspection or copying."

Under the current UCC text, a financing statement sufficiently provides the name of a debtor that is a registered organization only if it states the name indicated on "the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized." Some have asserted that it can be made clearer which record qualifies as a "public record which shows the debtor to have been organized" and that only one such record qualifies. It is certainly clear, under the current text, that the record that effects the organization or formation of the registered organization – articles of incorporation for a corporation, articles of organization for a limited liability company and a certificate of limited partnership for a limited partnership –constitutes a "public record that shows the debtor has been organized." The obvious undesirability of multiple qualifying records suggests that it should not be necessary to expressly negate that possibility. It might, however, be asserted that a certificate of good standing from the Secretary of State (or other appropriate office) of the debtor's state of organization also qualifies as a "public record which shows the debtor to have been organized." Although it would appear to have no merit, it might even be argued that the Secretary of State index also constitutes such a public record.

Experience has shown that the corporate offices (not the Article 9 filing offices) do not have uniform or even consistently applied polices regarding how they data-enter entity names, have (at least historically) typically generated and entered into the index abbreviations, and do not make an effort to assure that the name in the index is identical to that stated in the articles of the debtor to be the debtor's entity name. Indeed, organizers of the entity are often to blame for confusion in that they do not assure that the document title and the signature line (or other name references) of the articles conform precisely to the name set forth in the provision that purports to state the entity's name. In addition, there is always the possibility of a corporate office inputting error in the creation of the index. Although this is not the task of Article 9 filing officers, the corporate offices would provide a very useful public service by (i) adopting procedures that assure that the name in the index and good standing certificates is always identical to that set forth in the provision of the organizational document that purports to state the entity's name, and (ii) providing, online-accessibly and preferably at no charge, either the "correct" name (as herein described) or an image of the organizational document permitting the inquirer to ascertain for itself the "correct" name. A multiplicity of records (if they are inconsistent) that qualify as a "public record that shows the debtor has been organized" creates the possibility of discrepancies and differences. It is for these reasons that well-advised secured parties in the normal course of their due diligence (i) always examine the articles of the debtor, (ii) do not rely on the index or on a good standing certificate and (iii) use the Secretary of State's office records only to confirm that the public record of the articles corresponds to the copy of the articles and other information furnished by the debtor. In our experience, careful practitioners have so advised their clients since the initial enactment of the UCC.

UCC COMMITTEE RECOMMENDATION

The IACA goal to eliminate the possibility of there being more than one public record that qualifies under the statutory text has merit. The UCC Committee supports an amendment along the lines of the following text, and assuming that the "comprehensiveness" and "uniformity" criteria are satisfied.

The IACA-proposed change from "a single" to "one" in Section 9-102(a)(70) is not an improvement; it reflects a style preference only and indeed introduces a potential ambiguity not present in the current text. That proposed change should be rejected.

The IACA-proposed definition of "public organic record" might be revised to read as follows:

> "Public organic record" means the records (i) comprised of the record initially filed with a state or the United States to form or organize a registered organization and all records subsequently filed in the same office that effect an amendment or restatement of that initial record, and (ii) are available to the public for inspection or copying. For purposes of references in Part 5 of Article 9 to the name of a registered organization, in the event that any public organic record (whether an initial record or an amendment or restatement) mentions the name of the organization more than once, reference shall be to the name of the organization that the public organic record states to be the name of the organization. For purposes of references in Part 5 of Article 9 to the name of a registered organization, reference shall be to the most recently filed public organic record that is intended to state, amend or restate the name of the organization."

Establishing and identifying beyond all doubt a single source for the correct name for a registered organization furthers the goal of the current text to provide certainty and predictability.

The text suggested here is presented not as a merely stylistic alternative; it is presented to make the point that the solution should be comprehensive and address all known aspects of the problem.

The suggested second sentence of the proposed definition of "public organic record" addresses the question what is the correct name for purposes of Part 5 of Article 9 when a single record contains inconsistencies. For example, in many common formats, the name of an entity is found in the title of articles, in the signature line, and, typically, in the first paragraph (e.g. "The name of the corporation is: __________."). The name in the title and signature lines is intended merely for identification purposes, and the name in the first paragraph is intended formally to indicate the actual name of the organization.

The suggested third sentence of the proposed definition addresses the question what is the organization's name for purposes of Part 5 of Article 9 when there are more than one filed organizational documents in the public record. In such cases, the proposed text designates as the name of the organization the name provided in the most recently filed document that either states it to be the name of the organization or amends or restates the name of the organization. This is intended to focus on the most recently filed document that deals directly with the name—not necessarily the most recently filed document.

III. <u>Correction Statements</u> (IACA Proposal #2)

CURRENT LAW

UCC Section 9-518(a) provides:

9-518 (Claim regarding Inaccurate or wrongfully filed record):

"(a) A person may file in the filing office a correction statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed."

IACA PROPOSAL

IACA's proposal would amend UCC Section 9-518(a) to read as follows:

9-518(a) A person may file in the filing office a correction statement with respect to a record indexed there <u>if:</u>

<u>(1)</u> ~~under the person's name if~~ the person believes that the record is inaccurate or was wrongfully filed<u>, and</u>

<u>(2) one or more of the following applies:</u>

<u>(i) the record is indexed under the person's name;</u>

<u>(ii) the person would have been entitled to file the record pursuant to Section 9-509; and</u>

<u>(iii) the person filed the record</u>.

DISCUSSION

Section 9-518 was designed for a single purpose only--to provide to a debtor a means to address a "bogus" filing made against it by filing a correction statement that becomes part of the public record (this is, of course, neither the exclusive solution to address the problem of "bogus" filings nor the debtor's sole remedy, there being available in most states both civil remedies and criminal penalties). The Official Comment to Section 9-518 makes this clear and notes that filing of a correction statement by a debtor largely parallels the remedy in the Fair Credit Reporting Act that allows a person to state its position regarding a disputed amount on the public record.

The IACA proposal in no way furthers this debtor-protection purpose.

One change that would be effected by the IACA-proposed amendment to Section 9-518 is to provide to a secured party the means to file a response to a correction statement filed by the debtor. There is, however, no need for a secured party to file any response, as a correction statement does not affect the effectiveness of the initial financing statement or any other filed record. If the debtor's correction statement identified a problem with the filed financing statement, a secured party's responsive filing, which under the IACA proposal would also have no legal effect, is not the proper vehicle for the secured party to remedy the problem—only a filing having a legal effect, such as an amendment or a new initial financing statement, can accomplish this. Moreover, no negative implication could reasonably be drawn by any third party from the absence of a secured party's responsive filing; not only did the debtor's correction statement have no legal effect, but the secured party might not even become aware of the debtor's having filed a correction statement. This proposed change can serve only to mislead secured parties into wrongly thinking that they have corrected a problem with such a responsive correction statement.

A second, and still more controversial, change proposed by IACA allows a secured party to file a correction statement with respect to any financing statement that it had filed. This, of course, has nothing to do with "bogus" filings or debtor-protection. If there is an error in the financing statement, a secured party should make a filing that has legal effect, either a new initial financing statement or an amendment, not a correction statement that has no legal effect. This change risks converting the public record into an informational bulletin board (the effects of which would be uncertain and might introduce a notion of "record notice" not presently provided for in Article 9). This change would move the correction statement further away from its debtor-protection purpose.

Moreover, the language of the IACA proposal raises other issues as well. It expands the right to file a correction statement beyond a person under whose name the record is indexed (which must include the debtor (Section 9-519(c)(1)), but conceivably might embrace others), to also expressly include the person who filed the record and an otherwise undefined class--the "person who would have been entitled to file the record pursuant to Section 9-509."

UCC COMMITTEE RECOMMENDATION

The UCC Committee strongly opposes this proposal. Although publicizing errors made by filers has been mentioned as a potential benefit of the proposal, it is far from clear that any such benefit outweighs the distortion of a debtor-protection remedy and the introduction of uncertainty and risk of confusion.

IV. <u>Safe Harbor Forms</u> (IACA Proposal #4)

CURRENT LAW

UCC Section 9-521 provides:

> **9-521(Uniform form for written financing statement and amendment):**
>
> **(a)** A filing office that accepts written records may not refuse to accept a written initial financing statement in the following form except for a reason set forth in Section 9-516(b).
>
> **(b)** A filing office that accepts written records may not refuse to accept a written record in the following form except for a reason set forth in Section 9-516(b).

IACA PROPOSAL

IACA's proposal would amend UCC Section 9-521 to read as follows:

9-521

(a) A filing office that accepts written records may not refuse to accept a written ~~initial financing statement~~record in ~~the following~~a form ~~[~~approved by office [, nor may it refuse to accept a written record in the most recent form approved for nationwide use by the International Association of Commercial Administrators], except for a reason set forth in Section 9-516(b).

(b) A filing office that accepts written records may not refuse to accept a written record in the ~~following~~a form
approved by office [, nor may it refuse to accept a written record in the most recent form approved for nationwide use by the International Association of Commercial Administrators], except for a reason set forth in Section 9-516(b).

DISCUSSION

From the time of the initial enactment of Article 9, filing officers throughout the country generated unique paper forms to be used in their particular states (sometimes adopting forms also in use elsewhere). This process continued for decades. It obliged secured parties that had to file in more than one jurisdiction (because their collateral or their debtors were located in more than one state) to maintain supplies of numerous forms and to train their staffs to complete them properly. The multiplicity of state-required forms created inefficiencies in the financial services markets by delaying transactions, increasing the likelihood of errors and creating uncertainty regarding the effectiveness and timeliness of security interest perfection. As a result of these inefficiencies and uncertainties, a service industry developed to track the forms approved for use in the various states; while providing a useful service, these subscription services and filing services added to transaction costs and delays.

Against that background, the legislative policy, implemented in Section 9-521 of the current text, determined that there should be a single stable (because it was included in the statute) form that was accepted in all jurisdictions. The current text does not make the form mandatory from the standpoint of the filer—the filer is free to use any form that satisfies the statutory requirements. The current text also does not in any way inhibit any filing officer, or indeed, IACA, from developing or recommending use of one or more different forms—it simply prohibits every filing office that accepts paper filings from rejecting the Section 9-521 form on the basis of use of that form.

Thus, the sole purpose served by, and sole effect of, Section 9-521 is to provide a single "safe harbor" form that will be accepted in all jurisdictions, without risk of rejection on the ground of form. This is especially useful since, under the current text, a debtor that is a registered organization is located in its state of organization, and, thus, filers may well be filing in the filing office of a distant state in which they do not customarily file. By completing and submitting one of the forms in Section 9-521, a secured party can be certain that the filing office will accept the submission (provided that the requirements of Section 9-516(b) are satisfied and that the filing office accepts paper filings).

The IACA proposal would completely abandon the legislative goal by making the non-rejectable form for each state be the form designated by that state's filing office. This would eliminate a single national safe harbor form. IACA alternatively proposes that there be a single safe harbor form, but instead of the form found in Section 9-521 it would be a form from time to time promulgated by IACA. This proposal has several undesirable features. Unanimous approval by all filing offices is not a precondition to IACA adoption. Thus, IACA adoption does not mean that all states would in fact adopt that form. Moreover, the same inability to obtain unanimous agreement on a form makes it highly unlikely that all states would unanimously adopt the proposed alternative rule. Therefore, uniformity is unlikely to be achieved. IACA deserves praise for diligently pursuing uniformity by developing Model Rules and seeking to promote their adoption, and by regular communication and efforts to develop uniform procedures. These efforts have greatly improved the situation for filers during the past few years, but have not come close to establishing uniformity (not all states have adopted the Model Rules, not all have adopted them uniformly and not all have implemented them uniformly). Further, whatever flexibility might be gained by allocating form designation to IACA rather than enshrining the single safe harbor form in the statutory text is more than outweighed by the loss of stability. Filers should not be burdened with keeping track of whether and when IACA has decided to recommend a modified form. In addition, such legislative delegation to IACA might well be subject to legal challenge. While IACA must be commended for struggling with the improvement and standardization of the UCC forms, and the Committee endorses the stated goal of achieving uniformity, the proposed IACA amendment will unlikely achieve that goal and would in the meanwhile deprive filers of the current safe harbor. Even in the context of a package of amendments to Article 9, the concept of a national safe harbor should be maintained; if improvements to the forms have indeed been developed and are acceptable to all constituencies, those improved forms should be substituted for those presently in current Section 9-521. This does not require abandonment of the safe harbor concept or delegation to IACA of the power unilaterally to make further changes.

It should be kept in mind that the current Section 9-521 safe harbor forms were developed over an extended period of time before and during the Revision process, are based largely on the national transition forms developed in consultation with filing officers and reflect the comments and suggestions of filing officers, service companies and secured parties and their legal representatives. The forms were designed to reduce error by both filers and filing offices. The forms have not proved unusable and suggestions for changes have so far not attained universal agreement.

The argument in favor of the proposed amendment seems to be based on the erroneous belief that current Section 9-521 prevents a filing office from promoting a preferred form. This is an incorrect reading of the current text. Under the current text of Section 9-521, individual filing officers and IACA are free to propose, and the various filing offices are free to adopt, IACA-approved forms—and urge filers to use those forms.

No change is needed to Section 9-521 to permit the development and use of IACA-approved forms.

Although individual filing officers have from time to time proposed modifications to the form, the only item that has actually raised an issue of broad concern is the presence of a field for Social Security numbers. The form was adopted knowing that (1) most of the states did not require that data, indeed, that most states would discourage filers from providing that data, and (2) the form's instructions, on both the face and the reverse side, do discourage providing that data. However, at the time, it was not knowable whether all states would adopt that position and, in fact, on the enactment of Revised Article 9, the two Dakotas continued their prior policy of *requiring* the filer to provide that data. However, the current text does not in any way inhibit redaction of the data when it is provided, does not in any way inhibit filing officers from better educating filers not to provide that data, and does not in any way prevent filing officers from promoting the use of a form that is identical to the statutory safe harbor form but deletes that particular field. Thus, no modification to Section 9-521 is necessary in order to deal with the Social Security number issue.

Adoption of the IACA proposal to amend Section 9-521 would eliminate the safe harbor—the sole purpose of that provision—and would not enhance uniformity of either the statutory text or the paper form actually in use. To date local variations to Section 9-521 have been limited to a handful of states. Further tinkering with Section 9-521 should be discouraged.

IACA's proposal raises the additional question whether delegating to IACA the role of the sole determining body of the UCC safe harbor form, is a "permissible legislative delegation," or whether such action would be an unconstitutional delegation of legislative authority under a state's constitution. This threshold question would need to be overcome in all 50 states to make IACA's goal of uniformity even a possibility.

Finally, it should be kept in mind that Section 9-S21 deals only with paper forms. Thus, the magnitude of any perceived "problem" is a diminishing one as use of electronic filing becomes ever more widespread. Thus, perceived benefits of the proposal are outweighed by the problems engendered.

UCC COMMITTEE RECOMMENDATION

The UCC Committee strongly opposes this proposal. Experience has shown the need for and value of a single stable national statutory safe harbor form. This is compatible with, and no statutory amendment is needed to retain, the presently existing absolute freedom of each filing officer and IACA to develop and promote use of a different form.

GENERAL NOTE: Please note that if and when legislation with respect to any of the matters discussed in this Memo is introduced in California, the Committee is obliged to complete certain formal procedures required by the State Bar of California before the Committee can communicate its views on such legislation. If we then elect to do so, the Committee will evaluate such proposed legislation at that time and provide such comments on it as we deem appropriate after those procedures have been completed.

DELAWARE VERSION

§ 9-307. Location of debtor.

(a) "Place of business." -- In this section, "place of business" means a place where a debtor conducts its affairs.

(b) Debtor's location: general rules. -- Except as otherwise provided in this section, the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

(c) Limitation of applicability of subsection (b). -- Subsection (b) applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) does not apply, the debtor is located in the District of Columbia.

(d) Continuation of location: cessation of existence, etc. -- A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by subsections (b) and (c).

(e) Location of registered organization organized under State law. -- A registered organization that is organized under the law of a State is located in that State.

(f) Location of registered organization organized under federal law; bank branches and agencies. -- Except as otherwise provided in subsection (i), a registered organization that is organized under the law of the United States and a branch or agency of a bank that is not organized under the law of the United States or a State are located:

(1) in the State that the law of the United States designates, if the law designates a State of location;

(2) in the State that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its State of location; or

(3) in the District of Columbia, if neither paragraph (1) nor paragraph (2) applies.

For purposes of paragraph (2) above, if a registered organization designates a main office, a home office, or other comparable office in accordance with the law of the United States, such registered organization is located in the State that such main office, home office, or other comparable office is located.

(g) Continuation of location: change in status of registered organization. -- A registered organization continues to be located in the jurisdiction specified by subsection (e) or (f) notwithstanding:

(1) the suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or

(2) the dissolution, winding up, or cancellation of the existence of the registered organization.

(h) Location of United States. -- The United States is located in the District of Columbia.

(i) Location of foreign bank branch or agency if licensed in only one State. -- A branch or agency of a bank that is not organized under the law of the United States or a State is located in the State in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one State.

(j) Location of foreign air carrier. -- A foreign air carrier under the Federal Aviation Act of 1958 [see now 49 U.S.C. § 40101 et seq.], as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(k) Location of trusts and trustees. -- A debtor that is a trust that is a registered organization is located in the jurisdiction of the trust specified by subsection (e) or (f). A debtor that is a trust that is not a registered organization is located in the jurisdiction of the trust specified by subsection (b)(2) or (b)(3). A debtor that is a trustee acting with respect to property held in trust is located in the jurisdiction of the trustee specified by subsection (b), (e), (f) or (i).

(l) Section applies only to this part. -- This section applies only for purposes of this part. (72 Del. Laws, c. 401, § 1; 74 Del. Laws, c. 332, § 52.)

<u>MEMORANDUM</u>

FROM: Uniform Commercial Code Committee of the Business Law Section of the State Bar of California (the "Committee")

DATE: May 4, 2008

RE: Changes to UCC Article 9 Individual Debtor Name Provisions

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The debtor's name is the key to the Article 9 filing system, as financing statements are indexed by debtor's name and prospective secured parties and others search by debtor's name.[1] However, the degree of certainty that exists with respect to the name of a debtor that is a registered organization does not exist with respect to the name of a debtor who is an individual. While this issue has existed since the initial enactment of Article 9, concern about the issue appears to have grown recently and has provoked three states to enact non-uniform "solutions."

The Committee has begun its analysis of the problem generally and has analyzed in detail non-uniform amendments to Section 9-503 or 9-506 of Article 9 of the Uniform Commercial Code ("UCC" or the "Code")[2] enacted in Texas, Tennessee and Nebraska as they relate to the perfection of security interests against individual debtors, and, more specifically, as to whether such amendments appropriately address the issue of determining the name of an individual debtor for UCC filing purposes. ***In keeping with the Guiding Principles set forth below, the Committee believes that such individual state non-uniform amendments are undesirable and that the issues arising from individual debtor name filings should be fully analyzed by the Code's sponsor organizations (the ALI and NCCUSL, collectively referred to herein as the "sponsor organizations"). We believe that the well-established public participatory process carried out by the sponsor organizations is the method most likely to reach a carefully crafted and well-articulated solution that is consistent with Article 9 policies and that will enjoy support so widespread as to make likely a uniform and simultaneous nationwide adoption. We note that the sponsor organizations have created a Review Committee to consider and make a recommendation concerning whether there are problems under existing Article 9 that can and should now be dealt with by legislative amendment and, if so, to identify them. It is expected that the Review Committee will report its findings to the respective Executive Committees of the sponsor organizations within the next two months. It is also expected that the sponsor organizations will act promptly to appoint a Drafting Committee, if it is determined that amendments should be developed.***

This memorandum is a work-in-progress and may well be supplemented or revised to reflect the Committee's continuing research and analysis of the subject. This memorandum reaches definite conclusions concerning the non-uniform amendments enacted by the three states. Although the memorandum does not, at this stage, present a recommended definitive solution to the issues raised by filings against individual debtors, we have, in the Conclusions segment, presented some tentative

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[1] See, generally, Harry C. Sigman, *Twenty Questions about Filing under Revised Article 9: The Rules of the Game under New Part 5*, 74 Chi-Kent L. Rev. 861 (1999).

[2] Unless the context indicates otherwise, all references to "Article 9" are to the uniform version of Article 9 of the Uniform Commercial Code promulgated by The American Law Institute ("ALI") and The National Conference of Commissioners on Uniform State Laws ("NCCUSL") in 1999. Unless the context indicates otherwise, all "section" references are to sections of Article 9.

suggestions. We believe that our research and analysis has reached a point where this memorandum can contribute usefully to analysis and public discussion of the problems.

Please note that the positions set forth in this memorandum are those of the Committee only. They have not been adopted by the Business Law Section or its overall membership, or by the State Bar's Board of Governors or its overall membership and are not to be construed as the position of the State Bar of California. Membership on the Committee and in the Business Law Section is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources.

A. Guiding Principles and Criteria Generally Applicable to Analysis of Proposed Amendments to the UCC

The analysis of any proposed amendments to the UCC should be guided by the overarching principles (the "Guiding Principles") of: (A) preserving the uniformity of the UCC, and (B) maintaining the coherence of the UCC and consistency with the underlying purposes and policies of the UCC. Consequently, proposed amendments to the UCC should be analyzed based on the following specific criteria to determine whether the proposed amendments are (1) necessary, (2) appropriate, (3) comprehensive, and (4) uniform.

The first of these criteria, necessity, requires that there be a defect in the current text of the UCC that causes a problem in practice that can be solved by a change in the text. For example, where text has been subject to conflicting interpretations that have generated significant legal disputes or legitimate uncertainty causing significant cost or distortion of transactions, or have led to a result that is contrary to the underlying polices or purposes of the UCC, a change may be necessary. Attempts to "improve" on or "tinker" with the language of the UCC ("we can say it better"), where no serious need for a change has been demonstrated, or where there is no clear evidence that a real, rather than an imagined, problem exists under the current UCC text, should be resisted; attempts to make such changes raise the risk of unintended consequences and needlessly imperil uniformity due to the possibility that they will not be universally adopted. Even when it is arguable that the UCC might be improved by a particular amendment, an amendment is generally not advisable if the UCC, in its current form, will achieve the correct result. Changes should not be made to address problems that are the result not of a defect in the current text but of a mistake on the part of a person that failed to comply with the current text, unless the evidence suggests that a significant number of similar mistakes are being made, or are likely to be made, that can be attributed to ambiguous or confusing text.

The second criterion, appropriateness, requires that the amendment be directly targeted at correcting the problematic provisions in the UCC text. This requires precise identification of the problem and extensive and careful analysis of all of the options available to address the defect in the UCC text, and selection of the best solution among these options. The proposed correction for the defect should be complete and not incremental, and the costs, benefits, and burdens of the proposed change to all parties affected should be identified and taken into account. Furthermore, the language of the proposed amendment should be carefully tailored to address the identified defect and avoid unintended collateral effects. Finally, the proposed amendment should be in harmony with and fully integrated within the current UCC text.

The third criterion is comprehensiveness. As it is not feasible to engage in frequent legislative efforts on a nationwide level and frequent change may well result in instability, proposed amendments should, absent emergency, be gathered into a single comprehensive legislative package rather than being introduced individually or in small bundles. Thus, it must always be considered whether a particular amendment, even if meritorious, can be combined with other proposed amendments in a comprehensive legislative package to be presented simultaneously to all states. A comprehensive approach to UCC amendments makes it more likely that such amendments will be fully integrated with each other and with the remainder of the UCC text and will be consistent with the purposes and policies underlying the UCC. Only in exceptional cases, when evidence of serious and imminent actual or potential harm creates an urgent need for immediate action, should the need for a particular amendment outweigh the importance of acting with due deliberation to propose a comprehensive package of amendments.

A comprehensive package of proposed amendments is more likely to draw the attention, study and input of a far wider constituency, enhancing both the likelihood of quality and the greater likelihood of acceptance, i.e., simultaneous and uniform enactment, producing satisfaction of the fourth criterion, uniformity. A lack of uniformity among the versions of the UCC adopted by the various states leads to increased transaction costs, the potential for costly errors and unintended consequences. Although uniformity can never be guaranteed, a proposed UCC amendment not aimed at solving a unique local problem should not be enacted by a state unless there is evidence that it enjoys sufficient widespread support to make likely nationwide enactment. An endeavor to seek approval of a particular amendment on an ad-hoc state-by-state basis, without a substantial organizational effort on a national level, would be ill-advised and would likely jeopardize the essential uniformity of the UCC.

The best possible text of the proposed amendments, meeting the foregoing criteria and having the best chance of nationwide uniform enactment, is most likely to be achieved through a vetting of the proposed amendments by the co-sponsors of the UCC--the National Conference of Commissioners on Uniform State Laws and the American Law Institute—supported by the American Bar Association and state bar UCC committees around the country.

B. Summary of Conclusions and Recommendations

In keeping with the Guiding Principles, the Committee believes that individual state non-uniform amendments to Section 9-503 or 9-506 are undesirable and that the issues arising from individual debtor name filings should be fully analyzed, and solutions determined, by the sponsor organizations in the well-established process, resulting in carefully crafted solutions that are consistent with Article 9 policies and supported nationwide so as to make likely a uniform and simultaneous adoption. While there may be solutions that alleviate the problem of individual debtor names, including the possibility of a statutory designation that, for filing purposes, enables the identification of a unique name for each individual debtor, uncoordinated and non-uniform legislative proposals (even if developed after limited consultations with selected individuals in the field) are less likely to produce better results than a comprehensive and uniform amendment resulting from a deliberative and public process carried out by the sponsor organizations. There is insufficient evidence that the individual debtor name issue, while important, is of such urgency as to require states to act now in an uncoordinated and non-uniform manner. It does not appear that the Texas, Tennessee and Nebraska state actions are the result of unique local circumstances or an urgent need, and thus, such actions are contrary to the goal of preserving the fundamental uniformity of the UCC. Furthermore, the legislative actions to date are inconsistent with the policy of Article 9 to place the burden on the filer to provide the correct debtor's name.[3] These amendments differ from each other; generally, they do not provide relief for, and in many cases will significantly increase the burden on, searchers. Furthermore, the legislative amendments are not well-drafted. There is no demonstrated need to amend Sections 9-503 or 9-506 in a piecemeal fashion, rather than permitting such issues to be dealt with as part of a comprehensive UCC revision project.

C. Analysis of the "Necessity" for Amendments to Sections 9-503 or 9-506

The filing system is the heart of UCC Article 9. A financing statement must contain the debtor's name to be sufficient.[4] Section 9-503 provides specific rules for determining the debtor's name for various types of debtors that are not individuals. However, in the case of an individual debtor, the statute speaks only of providing "the individual . . . name of the debtor."[5] That term is not defined or otherwise elaborated on in the statute.

Section 9-506(c) provides that a financing statement that fails to sufficiently provide the debtor's name is not thereby rendered seriously misleading "[i]f a search of the records of the filing office under the debtor's <u>correct</u> name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a)."[6]

Under Section 9-503(a)(1), a debtor that is a registered organization debtor has, for "sufficiency" purposes, a single and unique debtor name - the one indicated on the public record of that debtor's jurisdiction of organization which shows the debtor to have been organized. There is no analogous source of single and unique individual debtor names that can be referred to for "sufficiency" purposes.

Whether a filed financing statement sufficiently provides the name of an individual debtor requires a two-step analysis:

1. Does the UCC financing statement provide the individual debtor's name?

2. If it does not, would a search of the filing office's records under the debtor's correct name, using the filing office's standard search logic, if any, disclose the financing statement?

The lack of certainty in the meaning of "individual . . . name of the debtor" in Section 9-503(a)(4), or the "debtor's correct name" under Section 9-506(c), is not created by Article 9 but rather stems from the absence generally of a nationally accepted definitive legal characterization of the concept. This lack of certainty has led to some anxiety concerning the filing rules. For example, the use of the term "correct" in Section 9-506 might be thought to raise an inference that there is only one correct individual debtor name; this inference, however, is only a possible, but not a necessary, inference. Several courts have

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[3] The rules reflect a balance between the competing interests of filers and searchers. The wider the latitude given to filers, the heavier the burden imposed on searchers. There are, of course, far more searches made than filings. It is noted, however, that in the limited category of purchase money non-inventory financing, it can be argued that having a cost-effective mechanism to assure perfection is more important than being able to confirm priority. While many of the reported decisions discussed in this memorandum relate to disputes between a secured party and a bankruptcy trustee, some involve disputes between competing creditors. The reported cases constitute a small and possibly unrepresentative sample of the actual disputes that have arisen over the years. This point is discussed further at text preceding footnote 39.

[4] UCC § 9-502.

[5] UCC § 9-503(a)(4)(A).

[6] UCC § 9-506(c) (emphasis added).

stated that the debtor's name for Article 9 filing purposes is the debtor's "legal" name.[7] These courts, however, did not define the concept of a "legal" name, and the text of Article 9 does not refer to a "legal" name.[8]

There does not appear to be an accepted national agreement, at least not a statutory one, on what a "legal name" is or how it can be ascertained. The common law generally recognizes the right of a person lawfully and effectively to change his or her name at will and assume a new name, so long as it is not done for a fraudulent or illegal purpose, without judicial involvement (although it is likely that a judicial procedure is an available alternative in every state). In a case that illustrates how an individual may use a variety of names without fraudulent intent, the name "Charles Chester Callaway" was given to the bankrupt by his parents shortly after his birth.[9] The Court described how the bankrupt used a variety of names:

> To distinguish him from an uncle, Charles W. Callaway, who lived in the same household, he was called "Chester." During his entire life he has been known in the community where he was born and has lived, by his family, friends, neighbors, and apparently by his creditors as well, as Chester, Chester C., Chet, or C. C. Callaway. On written documents he generally signed as "Chester Callaway" or "Chester C. Callaway." Only upon his induction into the army and in signing his petition in bankruptcy did he use the name "Charles Chester Callaway". His uncle, who still lives near by [sic], is known as Charles or Charles W. Callaway. All creditors in the bankruptcy proceeding referred to the bankrupt as "Chester Callaway" or "Chester C. Callaway."[10]

The Court then explained why any or even all of these names might be "legal":

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[7] See, e.g., *In re Berry*, 2006 WL 2795507 (Bankr.D.Kan. 2006); opinion supplemented by *In re Berry*, 2006 WL 3499682 (Bankr.D.Kan. Dec 01, 2006) (official UCC search conducted by the bankruptcy trustee on the Kansas Secretary of State's online system under "Michael R. Berry" yielded no reference to secured party's financing statement; held, financing statement referring to "Mike Berry" is "seriously misleading"); *In re Borden*, 353 B.R. 886 (D. Neb. 2006)(in adversary proceeding to determine priority dispute between an earlier-perfected secured party with blanket lien filed under the name "Michael Ray Borden" and purchase-money lien filed under the name of "Mike Borden," the use of the name "Mike Borden" rendered the purchase-money financing statement "seriously misleading" and therefore ineffective to perfect); and *In re Jones*, 2006 WL 3590097 (Bankr.D.Kan.2006)(bankruptcy trustee's official UCC search for liens against debtor who filed bankruptcy petition in the name of Christopher Gary Jones, using the "standard search logic" of the Kansas Secretary of State's office, did not reveal creditor's financing statement filed under name "Chris Jones;" financing statement held "seriously misleading.")

[8] At least one court mentioned that this conclusion finds support in the National Uniform Financing Statement Form. The instructions in the financing statement form set forth in UCC Section 9-521 state that the preparer should provide the "DEBTOR'S EXACT FULL LEGAL NAME." However, this does not, and should not be read as purporting to, modify the statutory language of Section 9-503, which requires only the debtor's "name." To begin with, the form is not obligatory; filers are not obliged to use that form (the purpose of the form is to provide a national safe harbor form, assuring filers that that form will not be rejected by any filing office in the country on the grounds of form). Further, the instruction, in redundant terms, was simply intended to stress the importance of providing the debtor's name accurately, to encourage the preparer to use diligence to determine it, and care in providing it, avoiding nicknames and mistakes. Had the drafters intended to require the debtor's "exact full legal name" as a condition to the sufficiency of the filing, they would have so stated explicitly in Section 9-503, and not hidden it in an instruction in the non-mandatory form provided in section 9-521, a form targeted at filing offices rather than filers. Nor does the reference in Section 9-506 to a debtor's "correct" name in any way modify the meaning of "name" in section 9-503. The word "correct" is used in Section 9-506(c) because that section deals with a financing statement that provides the name erroneously, obliging the safe harbor to be phrased in terms of disclosure by a search under the "correct" name.

[9] *Hauser v. Callaway*, 36 F.2d 667 (8th Cir. 1929)

[10] *Id.* at 669

> In the absence of any restrictive statute, it is the common-law right of a person to change his name, or he may by general usage or habit acquire a name notwithstanding it differs from the one given him in infancy. *(Citations omitted).* A man's name for all practical and legal purposes is the name by which he is known and called in the community where he lives and is best known. To use the language of the Pennsylvania Court, 'A man's name is the designation by which he is distinctively known in the community.' *(Citations omitted).* He may be as well known by one name as by another, and in such case the use of either is for most purposes sufficient. *(Citations omitted).*[11]

Academic writing also recognizes that an individual may have more than one legal name:

> At common law, an individual's legal name is "the designation of a person recognized by the law as correct and sufficient and constituting ... one given name followed by the family name and in modern times requiring or permitting one or more middle given names or initials in abbreviation thereof . . . ." *(Citations omitted).* Even the "legal" definition of legal name theoretically may permit an individual to have more than one legal name. See *625 Ill. Comp. Stat. 5/1-137.5* (2005) (defining legal name as the "full given name and surname of an individual as recorded at birth, recorded at marriage, or deemed as the correct legal name for use in reporting income by the Social Security Administration"). In addition, it is not entirely clear in some states whether a married woman is considered to have legally assumed her husband's name or whether a divorced woman may resume her birth name without court proceedings . . . .[12]

To further complicate matters, at least one court considering the issue of the sufficiency of the individual debtor's name for UCC filing purposes abandoned any analysis of the debtor's "correct" name, and instead relied on the competing secured party's "actual" knowledge of the debtor's nickname in ruling that the use of the nickname in the UCC financing statement was not seriously misleading because the competing secured party was not in fact misled.[13]

Prominent among the issues in determining an individual debtor's name is the use of nicknames. Characterization of an appellation as a nickname is a determination that it is not the debtor's actual name but instead a short, colloquial, informal or familiar substitute for the debtor's actual name. It is certainly possible, however, that given the common law understanding of what is a legal name in the U.S., a nickname could become the debtor's name, but in such case it would no longer be a nickname.[14] In a regime that permits a person to have only one name at a time, a nickname should not be

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[11] *Id.* at 669-670.

[12] Margit Livingston, *A Rose by Any Other Name Would Smell as Sweet (or Would It?) *: Filing and Searching in Article 9's Public Records*, 2007 B.Y.U.L. Rev. 111 (2007).

[13] See, *People's Bank v. Bryan Brothers Cattle Co*, 504 F.3d 549 (5th Cir. 2007) (holding that secured party knew debtor's nickname and therefore was not seriously misled by the financing statement filed by a competing creditor under the debtor's nickname). The briefs submitted by the parties in this case indicated that the searching creditor had over 200 papers in its file indicating the name under which the competing financing statement was filed. The Court emphasized that it was the creditor's *actual knowledge* of the name that made the use of that name on the prior financing statement "not seriously misleading."

[14] Due to the predominance in the reported individual debtor name cases of the nickname issue, it was debated by the Committee members whether to propose an amendment to Article 9 adding a provision explicitly declaring nicknames insufficient, similar to the "trade name" provision in Section 9-503(c) (which expressly states that a financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor). However, in light of the reality that a nickname can be used with such frequency and consistency that it ceases to be a nickname and instead becomes the debtor's name under common law, the proposal appears unlikely to be helpful. Consequently, this idea was dropped from consideration.

considered the debtor's name if the debtor does not abandon the debtor's formal name by clearly and consistently replacing the formal name with the nickname, with the intent to abandon that formal name; in a regime that accepts that a person may have more than one name at the same time, a nickname should be considered the debtor's name if the debtor uses it clearly and consistently, even if not exclusively, with the intent to adopt it as an additional name. If an individual uses various names at different times for different uses, the common law should not treat such sporadic and limited uses as constituting a change of name, giving rise to a new debtor name, since there would not under these circumstances appear to be the requisite intent to abandon the former formal name and replace it with a new formal name (however informal that new name might itself appear).[15] This discussion, admittedly a rough articulation of a difficult concept, illustrates the high degree of fact-sensitivity of the name determination under common law and the ultimate difficulty of statutorily defining a person's name, at least for general purposes.

Since July 1, 2001, when revised Article 9 became effective, eleven reported cases have dealt with individual debtor name questions. Of these cases, two dealt with a spelling error in the debtor's name,[16] two addressed difficulties arising out of non-U.S. cultural naming conventions,[17] one involved a filing that was held insufficient for failure to include the debtor's middle name,[18] and six involved filings

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[15] Likewise, if an individual uses "Jr." only on rare occasions when it is necessary to distinguish the individual from a parent, and does not otherwise use the suffix, the requisite abandonment intent might be present, with the consequence that the suffix "Jr." would no longer be considered to be part of the individual's name.

[16] *Pankratz Implement Company v. Citizens National Bank*, 130 P.3d 57 (Ks. 2006) (filing provided debtor's first name as "Roger" instead of "Rodger" – filing statement held insufficient due to incorrect name); and *Hopkins v. NMTC Inc. (In re Fuell)*, 2007 Bankr. LEXIS 4261 (filing under name of Andrew Fuel instead of Andrew R. Fuell – financing statement held insufficient due to incorrect name). [Note: the *Fuell* court did not discuss, or even note, the lack of the middle initial.]

[17] *All Bus. Corp. v. Choi*, 634 S.E.2d 400 (Ga. 2006) (filing under name "Gu, Sang Woo" instead of "Sang Woo Gu") and *Corona Fruits & Veggies, Inc. v. Frozsun Foods Inc.*, 142 Cal.App.4th 319 (2006) (filing under name "Armando Munoz" instead of "Armando Munoz Juarez.") In Corona Fruits, the court rejected an argument that the "debtor's name" should be determined based on Hispanic cultural naming conventions, stating, "The "naming convention" is legally irrelevant for UCC-1 purposes and, if accepted, would seriously undermine the concept of lien perfection."

Indeed, differing cultural norms present substantial problems in the presentation of individual debtor names. Any proposal for an amendment to the UCC should consider the ramifications of ethnic naming conventions on a nationwide basis as many regions have large populations of immigrants and in these regions non-Anglo naming conventions become relevant. For example, in China and other Asian, and even Easter European, countries, the sequence would generally be family name, given name. A Korean name consists of a family name followed by a given name (e.g., 8an Ki Moon, the U.N. Secretary General). In Spanish-speaking countries, an individual usually has two surnames (the surnames of each of the individual's parents); the father's surname usually precedes the mother's. For example, José Vasconcelos Calderón is *Señor Vasconcelos* ("Mr. Vasconcelos" in English), not *Señor Calderón*, and "Vasconcelos" is not his middle name. In the Arabic system, an individual would be addressed as a chain of names that trace back to the individual's family history. Moreover, Arabic names can be transliterated into the Roman alphabet in a number of different ways. For example, "Said al-Ghamdi" can be properly spelled "Saeed Al Ghamdi" or "Sayeed Alghamdi," depending on the method of transliteration employed. Until 2004, most people in Mongolia were identified strictly on a first name basis. Russian surnames generally differ depending on the individual's gender. Although these naming conventions may not arise frequently as immigrants generally adopt American naming conventions, these are issues that should be considered when relying on a system that demands an individual's correct name. One way to lessen confusion might be to require, for financing statement purposes, the debtor's "family name" rather than "last name." Given the diverse make-up of the US population today, any rule regarding individual debtor's names must provide filers and searchers alike with a way to identify a name that can form the basis for an alphabetical index suitable for searching.

[18] *Morris v. Snap On Credit, L.L.C (In re Stewart)*, 2006 Bankr. LEXIS 3014 (2006) (filing under name "Richard Stewart" instead of including debtor's middle name and filing under Richard Morgan Stewart IV) (Note: The standard search logic used by the Kansas Secretary of State's office disregards suffixes. It also treats middle names by equating middle initials with all names beginning with those initials and treats the absence of a middle name or initial as all middle names or initials. KAN ADMIN REG, 6016022(b)(8)(2003)).

using an individual's nickname.[19] This survey suggests that the ***predominant issue with respect to individual debtors' names is filer carelessness rather than legal uncertainty, and that the single most common problem was the use of a debtor's nickname.***[20]

Two of the six cases involving whether a nickname was seriously misleading were decided based on the court's determination that the secured party had actual prior knowledge of the debtor's "nickname." [21] The secured creditor's actual or constructive knowledge of alternate names used by a debtor should be irrelevant when a court determines whether the creditor used "the individual debtor's name" under Article 9." Four of the cases involving the sufficiency of a nickname held that such filings were "seriously misleading" because a search in the debtor's "legal" name would not reveal the "nickname" filings.[22]

More importantly, the case survey reveals that the predominant cause of individual debtor name problems, at least as disclosed by the reported cases (including the nickname cases), is filer carelessness, not a defect in the statutory rules or their expression.[23] In fact, of these eleven cases, from the limited facts provided in the cases, it is not clear that any of the cases would have been decided differently had

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[19] *In re Erwin*, 50 U.C.C.Rep. Serv. 2d 933 (Bankr.D.Kan. 2003) (filing under 'Mike Erwin' as the debtor's name was held not ineffective even though debtor's full name was 'Michael A. Erwin') (holding rejected by subsequent Kansas cases, discussed below); *In re Kinderknecht*, 53 U.C.C. Rep. Serv. 2d 167 (B.A.P. 10th Cir. 2004) (financing statements under 'Terry J. Kinderknecht' instead of 'Terrance Joseph Kinderknecht' were held insufficient under Revised § 9-503(a)); *In re Borden*, 353 B.R. 886 (D. Neb. 2006) (filing under "Mike Borden," instead of "Michael Borden" held insufficient); *In re Berry*, 2006 WL 2795507 (Bankr.D.Kan. 2006)(filing under "Mike Berry" instead of "Michael R. Berry, Jr.") Opinion supplemented by *In re Berry*, 2006 WL 3499682 (Bankr.D.Kan. Dec 01, 2006) (rejecting In re Erwin, 50 U.C.C. Rep. Serv. 2d 933 (Bankr. D. Kan. 2003)], *In re Jones*, 2006 WL 3590097 (Bankr.D.Kan.2006)(filing under "Chris Jones" instead of "Christopher Gary Jones" held insufficient); compare with: *People's Bank* v. *Bryan Brothers Cattle Co.* 504 F.3d 549 (5th Cir. 2007) (filing under "Louie Dickerson" instead of "Brooks L. Dickerson" held sufficient).

[20] It is noteworthy that these cases do not openly consider the possibility that what was initially a nickname may have become the debtor's name. (See discussion in text following note 13, supra.)

[21] *In re Erwin, supra*, n. 19, was decided by a bankruptcy court, predicting how a Kansas court would rule on the issue. Subsequently, the Kansas Supreme Court rejected the reasoning and the result. *People's Bank, supra*. n. 13, found that the financing statement was not seriously misleading, relying on pre-revision cases. The Court explained, "Peoples was put on inquiry notice that a security interest in the property of 'Brooks L. Dickerson' could be listed under the name 'Louie Dickerson'." Dickerson held himself out to the community as Louie Dickerson, and he used this name in bank accounts, bills of sale, and with others with whom he did business. This is important because evaluating whether a filing is seriously misleading requires a court to examine the facts in a particular case, although the focus should be 'on whether potential creditors would have been misled as a result of the name the debtor was listed by' in the financing statement" (Citations omitted). *Id.* at 559. The Committee believes that the court's analysis is faulty in several respects. Article 9's rules are not based on the notion of "inquiry notice," or, for that matter, even knowledge of an individual debtor's alternate name or nickname. Moreover, knowledge of a particular subsequent secured party of the use by a debtor of a nickname, without more, should not be relevant to the question whether the nickname made the financing statement seriously misleading (under the definitional approach that a nickname is not the debtor's name) and also should not be determinative of (although possibly might be relevant to) the question whether the debtor's use of the nickname has been of such a consistent and continuous nature and with the requisite abandonment intent as to convert that nickname into the "individual . . . name of the debtor" as referred to in Section 9-503(a)(4).

[22] See footnote 19, *supra*: *In re Kinderknecht*, 53 U.C.C. Rep. Serv. 2d 167 (B.A.P. 10th Cir. 2004); *In re Borden*, 353 B.R. 886 (D. Neb. 2006); *In re Berry*, 2006 WL 2795507 (Bankr.D.Kan. 2006); and *In re Jones*, 2006 WL 3590097 (Bankr.D.Kan.2006). ·

[23] For example, in *Corona Fruits & Veggies, Inc.* v. *Frozsun Foods Inc., supra* n. 17, the secured creditor had a photo identification and "green card" identification showing that the debtor's name as "Armando Munoz Juarez;" nevertheless, the financing statement was filed under the name "Armando Munoz." Elodia Corona, appellants' account manager, prepared the UCC financing statements and testified: "I don't know why I didn't put his (i.e., debtor's) last name (on the UCC-1 financing statement). I could have made a mistake . . . ." Ms. Corona was asked: "So the last name on all the Agreements is Juarez, but on the U.C.C. 1 Forms, you filed them as Munoz?" Ms. Corona answered, "Yes." *Id.* at 8. (Note that this testimony, while an unhelpful admission, does not address the argument that Munoz, the patronymic surname was, thus, the correct "last name" rather than the metronymic Juarez.)

the non-uniform rules enacted in Texas and Tennessee been in effect.[24] These cases suggest that rather than a better individual debtor name statute, what is needed are more careful filers. As for the Nebraska statute, it would have created a different result in a number of cases by protecting the filer vis-à-vis a subsequent searcher, but, as discussed below, only at a great cost to searchers, and often with a result that would be unfair and intuitively incorrect.

In light of the uncertainty in determining an individual debtor's correct name for UCC filing purposes, this Committee believes that the "necessity" criterion is satisfied at least to the extent of supporting the sponsor organizations' review of the individual debtor name provisions of Sections 9-503 and 9-506. However, cause for study by the sponsor organizations does not equate with cause for urgent action, or even necessarily for any action at all. The existence of a problem does not necessarily mean that there exists a solution the benefits of which outweigh its costs.

As discussed in Part A above, a demonstrated need for urgent action is required before uncoordinated and non-uniform individual state action with respect to any UCC amendments is justified. The preferability of more definitive rules for determining an individual debtor's name for filing purposes does not, in and of itself, warrant states to act independently and impair the uniformity created by the UCC, particularly in light of the relative dearth of cases (eleven) that have arisen with respect to the issue of individual debtor names during the last almost seven years since the effective date of Revised Article 9.

One source that has been asserted as demonstrating urgency (and thus purportedly justifying immediate independent state action)[25] is the "*The UCC Filing Flash*" newsletter.[26] The Committee has reviewed three of *The UCC Filing Flash* newsletter reports (the "Report(s)") mentioned as evidence of an urgent need to clarify the correct individual debtor name under Section 9-503. The Committee's review of the Reports indicates that the Reports fail to demonstrate that an urgent need exists to address the individual debtor name issue via independent state action.

The first Report, dated May 2006,[27] states that "At least 4,000,000 of the 20,000,000 active UCC financing statements contain seriously misleading debtor names under Revised Article 9" and "At least 10-15% of new financing statements being filed today are ineffective because the debtor name is seriously misleading." However, the Report then provides significant detail about errors in filings against *registered organization names* and *trust names* in Florida. Other than a very brief mention of multiple individual debtor names in section 7 of the Report, there is no substantive discussion of a significant problem with respect to individual debtor names.

The second Report, dated August 2006,[28] surveys debtor name filings in Vermont. It reviews 53,530 Vermont financing statements containing 40,618 different individual debtor names, filed from July 1, 2001 to June 2006. The Report finds issues with respect to the first names of individual debtors in about

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[24] See footnote 41 and accompanying text.

[25] Per e-mail dated March 20, 2008 (9:31 a.m.] from Susan E. Collins to the America Bar Association's ("ABA") Filing Office and Search Logic ("FOOSL") subcommittee: "[The] debtor name issues pose a current and potentially substantial risk to secured parties, as has been admittedly known to but unaddressed by the NCCUSL group for the last 50 years. R9 has now made these issues critical to secured parties, as evidenced by Carl Ernst's factual studies of these issues in 2 specific states."

[26] *The Uniform Commercial Code Filing Guide, UCC Revised Article 9 Alert*; published Carl R. Ernst, Publisher and Executive Editor, Kathryn L. Teal, Esq., Editor

[27] *UCC Revised Article 9 Alert*; *supra*, n. 27, Issue 06-1; May 2006 (Special Report).

[28] *UCC Revised Article 9 Alert*; *supra*, n. 27, Issue 06-2; August 2006 (Special Report).

7,000 (13%) of the filings against individual debtors, but concludes that most debtor name inconsistencies arise from the filer presumably using debtor nicknames (4,949 filings or 9% of the total filings, or almost 70% of the presumptive misleading individual debtor name filings). The Report notes (as discussed in the text above) that names that are common nicknames can be the actual name (and not a nickname) of the individual.[29] A much smaller percentage of the presumptive misleading individual debtor name filings in Vermont (1,302 or 2.4% of the total) were due to "uncommon" first names (defined in the Report as names used by less than 10% of the population according to U.S. Census Bureau statistics). The presumption that the uncommon names are in error would appear to point to filer error as well (i.e., filers are misspelling individual debtor names). Other individual debtor name errors cited in the Report are multiple last names (409 filings in total or less than 1%) and first initial only (177 filings in total). It would appear that only the "multiple last name" group of filings, less than 1% of the filings in Vermont, could be attributed to non-filer error (i.e., errors that could not be resolved with the proper exercise of due diligence and care by the filer). The Report concludes that 10-15% of individual debtor names are seriously misleading, and advocates that lenders exercise greater due diligence when filing. It appears that most of the incorrect individual debtor name filings cited in the Report are the result of filer error.

The third Report, dated June, 2007,[30] editorializes in favor of the then Texas legislative proposals, including the Texas bill on individual debtor names.

These Reports do not support the conclusion that there is a crisis in determining an individual debtor's correct name for searching and filing UCC financing statements. If anything, the studies establish that there may be widespread filer errors when filing against individual debtor names. It is difficult to conclude that the data cited in the Reports establish the existence of a crisis demanding immediate individual state solutions rather than the initiation of the national process of the sponsor organizations.

Such urgency is also not established by the fact that the absolute number of filings against individual debtors is greater than the number of filings against organizations. Although we have no data that establishes this as a fact, we suspect that the dollar volume of credit secured by Article 9 filings against organizations is significantly greater than that secured by filings against individual debtors.

Nevertheless, due to the increased concern about uncertainty as to an individual's "correct" name and the significant volume of filings against individual debtors,[31] it is the Committee's view that a study to determine the need for and feasibility of coordinated action to amend Article 9 to clarify the "correct" debtor name is justified; the sponsor organizations are already moving to deal with this matter. However, the Committee does not believe that the individual debtor name issue is of such urgency that it warrants hasty independent action by individual states outside of the established national UCC amendment review and deliberation process.

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[29] The Special Report states: "4,949 (9% of total) financing statements contain one of the 225 nicknames listed in Appendix 1. Of course, some of these names, such as Jack or Dan, may also be actual first names, but a secured party must take care to be certain that such a name is not a nickname." *Id.* at page 6.

[30] *UCC Revised Article 9 Alert*; *supra*, n. 27, Issue 07-2; June 2007(Special Issue – June 2007).

[31] The California Secretary of State estimates that approximately 30% of all filings in the State name individual debtors; in Texas, the Committee has been advised that such filings represent approximately 50% of the filings. We have also been informed anecdotally that more and more farmers are now using family trusts as their preferred mode of operation rather than doing business as individuals.

Texas was the first state to enact legislation amending the debtor's name provisions of its version of Article 9.[32] Nebraska recently amended Section 9-506 of its Article 9.[33] Fortunately, Nebraska subsequently deferred the effective date of that legislation until late next year to enable the Legislature to revisit the issue. Tennessee recently amended Section 9-503 of its Article 9.[34] These three state non-uniform UCC amendments are discussed in the following sections.

D. <u>Texas Legislation</u>

The Texas statute has added to its version of Section 9-503(a) the following provision, designated as subsection (4), and renumbered uniform subsection (4) as subsection (5):[35]

> (4)[A financing statement sufficiently provides the name of the debtor] if the debtor is an individual, if the financing statement provides the individual's name shown on the individual's driver's license or identification certificate issued by the individual's state of residence . . . .[36]
>
> (5) in other cases:
>
> (A) if the debtor has a name, only if the financing statement provides the individual or organizational name of the debtor . . . .

The first problem with the Texas statute is that it is unclear whether it is intended to make the name on a described driver's license[37] a safe harbor (sufficient by statutory fiat, but not necessarily the only sufficient name) or a statutory exclusive (the only one that would be sufficient) name for Article 9 filing purposes. The new Texas text lacks the word "only" found in every other subsection of 9-503(a), and subsection (5)(A) refers to an 'individual name.' This suggests that new subsection (4) was not intended to be exclusive and that only a safe harbor was intended. In that case, a filer might provide an individual debtors' name sufficiently either by providing the name on a described driver's license or by providing a name that would have been sufficient under a 'uniform' analysis. On the other hand, a Texas court might interpret subsection (5)(A) of the Texas statute ("other cases") as being applicable only when an individual debtor does not fall under subsection (4), e.g., does not have a driver's license issued by a state of residence, in which case, subsection (4) is not a safe harbor but is instead the determinant of the sole sufficient name in cases where an individual debtor has been issued a driver's license by a state of residence.

In addition, several subsidiary questions may be posed:

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[32] Tex. Bus. & Com. Code Ann. § 9.503(a).

[33] NE L 2007, LB 851, § 28. Enacted on March 28th, 2008.

[34] State of Tennessee Senate Bill 3732. Enacted on March 25, 2008; Tennessee Acts 2007, ch 648.

[35] Former paragraph (4) of the Texas statute has been re-designated as paragraph (5). The Texas statute has also made a change with respect to the name of a registered organization. Discussion of that portion of the statute is outside of the scope of this memorandum.

[36] Please see Exhibit A for a comparison of the Texas and uniform versions of UCC 9-503.

[37] Unless the context otherwise requires, references to driver's licenses in our discussion of the Texas statute should be understood to include identification certificates.

- Must the name provided on the financing statement be the full and exact replication of the name on the license or would either or both "Joseph Jones" or "Joseph A. Jones" be sufficient if the name on the license is "Joseph Alan Jones"?

- What if the debtor has more than one state of residence [compare Section 9-307(b)(1), which refers to an individual's "principal" residence] and either has or doesn't have a driver's license issued by Texas?

- As of what time is residence to be determined—when the license relied on was issued, when the financing statement is filed, or some other time?

- How is the Texas statute to be applied if a debtor has (even in the absence of fraudulent intent) licenses with different names issued by the same state at different times or by different states of residence (at the same or different times)?

- What is the effect of the Texas rule in a case where the debtor, after a filing in Texas in reliance on the Texas amendment, changes his or her location to a state that has the uniform text?

- What is the effect of the Texas statute in a case where the debtor becomes a resident of Texas after a filing was made in another state (while the debtor was resident there) that had the uniform text, if the name provided in that filing differed from the name on the debtor's driver's license (whether a Texas license or a license issued by the prior state)?

- Does the statute have any effect with respect to a filing made before the effective date of the enactment?

A text that provided responses to these questions would have been preferable. If a safe harbor was intended, that could have been more clearly indicated.[38]

If it is a safe harbor, the Texas amendment does nothing for searchers, who still must apply the 'uniform' analysis and search under any name that might be sufficient under the uniform text. If it is a statutory exclusive name, it still leaves searchers forced to make determinations as to whether and when the debtor might have fit within subsection (4), where and when the debtor might previously have resided and whether the debtor has now or at any time in the past had a driver's license with a name different from that on the license he or she is presenting to the searcher, information that is likely to be difficult and/or expensive to obtain without the cooperation of the debtor.

Proponents of the Texas amendment essentially argue that, whatever the flaws, the incremental benefit to filers outweighs all counter-considerations. It is hard to accept this, particularly if the statute is only a safe harbor, since that still leaves the filer, along with all other searchers, with the task of engaging in a 'uniform' analysis in order to conduct an effective search. At best, it frees the filer from making a few precautionary extra filings that a prudent filer in a uniform jurisdiction might choose to make, and the

[38] Perhaps this might have been achieved by placing an amendment in Section 9-506 of the Texas UCC rather than Section 9-503. Alternatively, this might have been achieved by, instead of changing Section 9-503(a) of the Texas UCC, inserting a new subsection at the end of Section 9-503 (or Section 9-503(a)) to the effect that, for purposes of Section 9-503(a)(4)(A], a financing statement that provides the individual's name exactly as shown on the individual's driver's license or identification certificate issued by the state of the individual's principal residence at the time of filing sufficiently provides the individual debtor's name, with an express indication that that source is not exclusively determinative of the debtor's name.

potential of having to file continuations with respect to those extra financing statements. Given the relatively low filing fees prevalent in the U.S. and a relatively small percentage of financing statements that are continued, is this burden so great? Further, are there really so many individual debtors who have more than three or four potential "names" [the most common variables being: (i) given name and surname; (ii) given name, middle initial and surname; and (iii) given name, middle name and surname]?[39]

If it is a safe harbor, the Texas amendment does not protect the filer against a prior filed financing statement under a different name that is also sufficient. Thus, in cases where priority, rather than merely perfection effective against the debtor's bankruptcy trustee, is of concern, the Texas amendment is insufficient. It is certainly true that some percentage of credit extended to individual debtors is non-inventory financing on a purchase money security interest ("PMSI") basis. Several of the cases cited above involve trustee avoidance actions, rather than priority disputes among competing secured parties. Since PMSI rights with respect to goods other than inventory and livestock require only timely perfection to enjoy priority over earlier filers, this particular class of secured parties would benefit from a safe harbor rule.[40]

Obviously, the Texas amendment does nothing with respect to the most common problem revealed by the cases—filer error. The Texas amendment should not help a filer that determined the debtor's name on a driver's license before misspelling it on the financing statement. The results of the cases surveyed in this memorandum would not likely be different had the Texas amendment been in effect.[41]

It should also be noted that the scope of the safe harbor provided by the Texas statute is, presumably unintentionally, limited to cases in which the debtor is an individual. It does not apply to filings when the debtor is a trust or a decedent's estate, filings that use the names of individuals in providing the debtor name. In cases where farmers are borrowing in the name of a family trust rather than as individuals, a legislative amendment like the one in Texas would not offer any additional protection to either filers or searchers of such a debtor.

Another concern raised by the Texas statute is its reliance on the integrity of driver's licenses or identifications cards as a source for the individual debtor name. Driver's licenses and identification

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[39] This question should be considered in light of the suggestion made in the Conclusions of this memorandum.

[40] Another situation where lenders may be less concerned about priority is when a lender is willing to extend credit to an individual secured by existing personal property and the transaction is too small to justify a priority search and the lender is willing to rely on the representations of the borrower. In that case, the lender may be satisfied with confirmation of perfection only.

[41] The Committee could not ascertain from the cases whether the parties involved used a driver's license to determine the debtor's name. It is possible that some of the nickname cases would have been decided differently under the Texas and Tennessee debtor name statutes. For example, if the driver's license, in the case of the Texas statute, or the other referenced documents, in the case of the Tennessee statute, reflected the debtor's nickname as the debtor's name on a listed acceptable document, then the filings would have been deemed effective (but would still not have assured priority if a prior filer had provided a different but also sufficient name). However, most of the cases fail to indicate what documents, if any, were relied on to determine the debtor's name. In several cases that did reference a source document, the filer simply incorrectly reflected on the financing statement the name shown on that document. No statute can excuse such filer error without creating a gross burden and injustice for searchers. This is the effect (along with producing absurd results in particular cases) of the Nebraska statute. In cases where the appellate court simply referred to the debtor's "legal" name as established at the trial court level, there was no explanation of how the trial court determined the "legal" name. And there were cases in which the court found that the erring party knew the debtor's "correct" name and for some unexplained reason failed to use it; that same filer error could occur if a driver's license was the basis for determining the debtor's "correct" name.

cards are notorious for their unreliability.[42] Significant opportunities exist for individuals to obtain multiple (at least sequentially and whether or not fraudulently) driver's license and identification cards.[43] A review of driver's license issuance requirements in a variety of states suggests that at present most states require (whether or not these requirements are diligently enforced) foundation documents. In California, the Department of Motor Vehicles verifies that the "foundation" document requirements for a driver's license, which requirements are almost identical to the requirements of the REAL ID Act, are also the same for the state-issued ID card, with the exception that an individual can use his or her driver's license as a foundation document for the state-issued ID card.[44]

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[42] National Conference of State Legislatures Report on Driver's License Integrity, http://www.ncsl.org/statefed/DLRCSG.htm (last visited March 8, 2008) states:

> "All states verify the identity of a potential license holder before issuing a driver's license. The documents used to verify identity for this purpose are known as "foundation documents" because they provide the building blocks of personal information on which the license is issued. Foundation documents range from birth certificates, to utility bills, to passports, to other states' driver's licenses. **The principal challenge related to foundation documents is states' ability to verify their authenticity and validity. States do not routinely verify, for instance, that the foundation documents with which they're presented are authentic (i.e. that the document is genuine) or valid (i.e. that the document is eligible to be used).** For example, a deceased individual's birth certificate is authentic, but it is invalid for use as a foundation document for a driver's license . . . . Currently, few states actively verify foundation documents . . . .
>
> A second but related issue is the process by which a state ensures that the individual presenting valid foundation documents is indeed the individual to who those documents belong. It is possible, in other words, for Jane to present Sally's birth certificate and get a valid driver's license in Sally's name. The birth certificate itself is an authentic document but it does not belong to the person presenting it." (emphasis added)

[43] The National Conference of State Legislatures' Report on Driver's License Integrity states:

> Fraudulent issuance of driver's licenses comes in two forms – fraud that occurs without the cooperation of the licensing authority and fraud that occurs with it. It is clear that the current system provides an individual who chooses to produce fraudulent foundation documents with a significant opportunity to illegally hold a valid license or licenses.

As a result of the homeland security concerns raised by 9/11, many states have revised their laws in an effort to make driver's licenses harder to forge (through the use of holograms, bar codes, etc.) and harder to obtain. It is possible that some of the identified problems with respect to using driver's licenses may be eliminated when states comply with The Real ID Act. However, states have been able to obtain extensions of time to comply with the Act. At present, driver's licenses suffer from too many indicia of unreliability to provide an effective or practical solution to determining a unique actual debtor name.

[44] Compare: REAL ID Act: §202(c)(1), Minimum Drivers License/ID Issuance Standards:

At a minimum, a state shall require the presentation and verification of the following information:

1. A photo identity document (except that a non-photo identity document is acceptable if it includes both person's full legal name and date of birth)
2. Documentation showing the person's date of birth
3. Proof of the person's social security account number (SSN) or verification that the person is not eligible for an SSN
4. Documentation showing the person's name and address of principal residence

vs. California drivers license documentation requirements (See: http://www.dmv.ca.gov/dl/dl_info.htm#BDLP):

1. Complete application form DL 44.
2. Give a thumb print
3. Have your picture taken

Each state lists a variety of documents that are usable to establish the applicant's name and date of birth. However, not all states require photo identification. An individual could obtain a driver's license in another person's name and, conceivably, obtain multiple licenses in this fashion.[45] As a result of these realities, significant opportunities exist for individuals to obtain fraudulent driver's licenses and identity cards. Furthermore, a political issue being debated in several states is whether to issue driver's licenses to undocumented aliens. It remains to be seen whether this expansion will be enacted. On the other hand, with heightened security concerns in the U.S., and the potential for the Real ID Act to have some impact (even if that Act never takes full effect), it may well be that a driver's license will become much more reliable in a few years from now than it is today.

Not everyone has a driver's license or identification card. However, this does not appear to be a significant issue. According to the U.S. Department of Transportation, Federal Highway Administration, as of 2005, approximately 67% of the "Total Resident" population of the United States holds a driver's license.[46] However, of the segment of the population that does not hold a driver's license, a significant portion of the adults within that segment is likely to hold a state-issued identification certificate. Without the benefit of any empirical data, the Committee suspects that only a very small segment of the population seeking financing in an individual debtor name would not hold, or be able fairly readily to obtain, a state-issued driver's license or state-issued identification card.[47]

The Committee also considered the delay in transaction timing, or increase in transaction costs, entailed in obtaining a driver's license or identification card in those cases where a debtor does not already possess such identification. The Committee reviewed the process and requirements for obtaining a driver's license or ID card from the State of California[48] and found that the State of California issues a temporary driver's license or ID card upon application at the counter at any local office of the Department of Motor Vehicles, effective until the official photo ID is mailed by the DMV typically several weeks later. The temporary card does not have a photo. However, as the primary goal of the Texas solution is determining the correct individual debtor name for filing purposes, and not avoidance of fraud (which is a legitimate concern, but a separate consideration), the individual debtor name found on a temporary driver's license or state-issued ID card should be sufficient for filing purposes. In light of the ease in obtaining a driver's license or identification card, it does not appear to be a great burden to require that individual debtors obtain a driver's license or state-issued ID card as a pre-condition to the

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4. Provide your social security number. It will be verified with the Social Security Administration while you are in the office.
5. Verify your birth date and legal presence
6. Provide your true full name

[45] Indeed, an individual can obtain multiple drivers' licenses in different names, without having fraudulent or malicious intent Anecdotally, one of the Committee members had the experience of simultaneously holding two California drivers' licenses, each in a different name. She held a license in the name of "Edith Gail Resnick-Warkentine." (The DMV, without having been requested to do so by her, had originally hyphenated her maiden and married names when she married.) When she asked the DMV to correct the license to reflect her "true" last name, the helpful DMV employee changed the name to "Edith Gail Resnick Warkentine." She retained possession of the unexpired license with the "last" name of "Resnick-Warkentine" and received her new license with the "last" name of "Warkentine" almost two months before the first license expired.

[46] See: http://www.fhwa.dot.gov/policy/ohim/hs05/pdf/dl1c.pdf . (Last visited on April 20th, 2008). These numbers are even lower in Texas – 64% of the Total Population. It is unclear if "Total Population" as used in this report refers to all residents, the driving population, or adult population.

[47] This seems to be borne out by information in the press accounts of the recent U.S. Supreme Court "Indiana voter ID" case. See e.g., The Economist, p. 38 (May 3, 2008).

[48] See: http://www.dmv.ca.gov/dl/dl_info.htm#BDLP. (Last visited April 20th, 2008).

financing transaction. This would result in only a very modest delay in, or increased cost to, the transaction.

For the reasons stated above, the Texas non-uniform provision cannot serve as a model solution, even if one accepts the driver's license as a useful source for establishing the individual debtor's name

E. Tennessee Legislation

The Tennessee legislation[49] amends Section 47-9-503 of the Tennessee UCC to provide that a financing statement sufficiently provides the name of an individual debtor only if the financing statement provides the individual's name shown on one of the following items: (i) a driver's license or identification card issued in lieu of a driver's license, (ii) a birth certificate, (iii) a passport, (iv) a social security card or (v) a military identification card.[50]

This statute, although superficially similar to the Texas statute, differs from it in several important respects, but unfortunately also does not provide a useful model for other states to follow. It does not provide multiple "safe harbors." The "only if" language makes clear that the statute is intended to mandate five alternative sources (exclusive of any other source) for a sufficient name for Article 9 filing purposes, regardless of the name actually used by the debtor, the name by which the debtor is commonly known, the name which the debtor uses routinely to sign documents, and the debtor's "legal" name for any other purpose. There are surely many persons who have never used or been known by the full names exactly as shown on their birth certificates. Moreover, the effect will be that secured parties and their counsel exercising careful due diligence will be compelled to examine and take into account all five specified sources of identification. All searchers will be compelled to search against each name shown on each such form of identification (past or present).

The Tennessee amendment does not provide explicit guidance for the resolution of priority disputes among filers that used different sources; presumably it is intended that the "first to file" would prevail, as each such financing statement would be "sufficient." However, the poorly drafted section 3, which appears to be intended as a transition provision, might make this issue ambiguous in the context of pre- and post-effective date competing secured parties. The Tennessee statute will likely increase the extent of due diligence beyond that currently conducted by secured parties. This additional due diligence will increase overall costs for conducting secured financing transactions in Tennessee.

Furthermore, several of the listed sources raise potential questions. The driver's license is not in any way (e.g., by residence) limited to one or even a few issuing states. Is the passport intended to refer only to U.S. passports or also to those issued by other nations? If the birth certificate or the passport may be one issued by any nation, might there be special reliability concerns? With respect to the integrity of the driver's license issuance process, see the discussion in Section D of this memorandum regarding the Texas legislation.

The other source documentation identified in the Tennessee act also suffers from reliability issues. Birth certificates do not contain photos, nor do they reflect formal or informal legal name changes that may have occurred since birth. A U.S. passport may be obtained by presentation of a certified copy of a birth

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[49] State of Tennessee Senate Bill 3732. Enacted on March 25, 2008; Tennessee Acts 2007, ch 648.

[50] Please see Exhibit B for a comparison of the Tennessee statute to the equivalent uniform version of UCC 9-503.

certificate and driver's license, making it no more reliable than a driver's license.[51] A social security card has no photo identification and also may not reflect name changes that may have occurred since the issuance of the social security card.

The Tennessee statute, like the Texas statute, fails to specify whether the name must be the name exactly as shown on the source document relied on. Arguably, if a driver's license identifies an individual as "John Ramsey Smith," a financing statement satisfies the statutory requirement if it provides the debtor's name as "John Smith" or as "John R. Smith" as each of these is "shown" on the driver's license.

Subparagraph (5) indicates that "in other cases" the name of "the individual" is sufficient, without referring back to Section 47-9-503(a)(4). Is this language consistent with the apparently intended exclusivity of the items listed in (4) as the possible source of the "debtor's name"?

Furthermore, the Tennessee act's "statement of intent" is troubling. The statement provides: "It is the legislative intent to create a broad safe harbor for the use of a debtor's name in any form permitted by this act." In fact, the statute is far more than a safe harbor. Shouldn't the statute be limited to the provision of a debtor's name on an initial financing statement, or an amendment of the debtor's name, only? Also, the references to "forms" and "filings" do not conform to the existing medium-neutral language used in Article 9. The statement of Intent refers to financing statements that are "validly filed." This term is not used in Article 9. The confusing reference to a filing that was "validly filed" and "continues to be valid" should be clarified to explain how such a filing would be affected by the "safe harbors" created.

Finally, the statement of intent to the Tennessee statute provides that the statute shall have retroactive effect (although this retroactivity would not appear to offer any benefit to searchers because prior valid filings remain effective). Does this retroactivity raise a constitutional issue? Depending on the facts and on how it is interpreted, it might raise significant issues of fairness for earlier filers.

The Tennessee statute is both poorly thought-through and poorly drafted, highlighting the need for a thorough and more expert process of the sponsor organizations.

F. <u>Nebraska Legislation</u>

On March 13, 2008, the Nebraska Legislature passed LB 851.[52] It was signed into law by the Governor on March 19, 2008.[53] Fortunately, subsequent legislation postponed the effective date of this provision of LB 851 until late 2009, allowing an opportunity to revisit this non-uniform provision before it does any harm. If left to go into effect unchanged, this provision will have a significant impact on those who extend credit to (and presumably conduct UCC searches against) individual debtors in the State of Nebraska.

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[51] Specifically, to obtain a U.S. passport one must show proof of citizenship and proof of identity. Proof of <u>citizenship</u> is primarily shown through a previous passport or a certified copy of a birth certificate, but there are other options. Proof of <u>identity</u> may be shown through a previous U.S. passport (mutilated, altered, or damaged passports are not acceptable as proof of identity), Naturalization Certificate, or current valid Driver's license, Government ID: city, state or federal; or Military ID: military and dependents. http://www.travel.state.gov/passport/get/first/first_832.html (last visited March 9, 2008).

[52] State of Nebraska Legislative Bill 716, which was amended to become part of Legislative Bill 851.

[53] NE L 2007, LB 851, § 28. Enacted on March 28th, 2008.

The Nebraska legislation amends Section 9-506(c) of the Nebraska UCC to provide that a financing statement is sufficient if a search under just the correct last name of the individual would disclose the financing statement.[54] It appears that the intended effect of this legislation is that, regardless of the nature and extent of an error, first and middle names will have no impact on sufficiency of a financing statement.

The legislation can be read to make a financing statement sufficient in Nebraska so long as the debtor's last name is correct, regardless of errors of the type which courts have almost unanimously found to be seriously misleading. By its focus on last names only, the legislation ignores the possibilities of filings under a debtor's nickname, or filings where the surname is correct, but the first name is misspelled, or filings without middle names – all examples of errors that have been found seriously misleading because a financing statement was not found using a filing office's standard search logic. A filing that provides a completely wrong first name, so that the financing statement fails by any standard to reflect "the debtor's name," would be found to be not seriously misleading. This legislation would make all such erroneous financing statements effective. That result is completely contrary to the intended result under Article 9.[55] Ultimately, the Nebraska statute would have a significant effect on the results in most of the debtor name cases discussed above, but that statute would lead to the wrong results. This statute protects the careless filer at the cost of the diligent searcher, and would lead to what most would agree is the "incorrect" result. The UCC should not protect careless or incorrect filers.

As a consequence of this legislation, searchers will have to review *every financing statement that provides the same last name as the individual name searched*. This could be a monumental task. For example, a UCC search of the individual last name "Johnson" on the Nebraska Secretary of State's web site produces *2,671 unique active records*.[56] Each would have to be reviewed as part of a diligent search. The risk and due diligence burden on searchers will increase significantly in Nebraska.

By reducing the determination of the correct name of an individual debtor to an examination of the surname only, the Nebraska legislation completely reverses the balance between filers and searchers reflected in the policy of Article 9.[57]

The Nebraska statute highlights the need for a thorough and careful review process. The Nebraska statute significantly increases the burden on searchers, and the Committee hopes the statute will not be allowed to go into effect.

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[54] Please see Exhibit C for a comparison of the Nebraska statute to the equivalent uniform version of UCC 9-506.

[55] Consider, for example, the possible absurd result where Lender A lends to "William Smith" but files against "John Smith". Searcher B searches under the correct name, "William Smith," but he would lose to Lender A, as the improperly filed filing under "John Smith" would be found by just searching "Smith." This is an example of protecting the incompetent filer at the cost of the subsequent searcher, who now has to consider every financing statement disclosed by a search under "Smith," Moreover, the searcher has no way of knowing that the filing against "John Smith" is intended to be a filing against "William Smith." The address on a financing statement is a very unreliable filter. Debtors have multiple addresses (Article 9 does not require any particular address from among several possible addresses) and debtors change addresses frequently, so a different address from the one known to the searcher does not establish that the financing statement relates to a different debtor.

[56] This statistic is attributed to Paul Hodnefield, Associate General Counsel, *Corporation Service Company* in an e-mail dated March 18, 2008 (8:50 a.m.).

[57] This policy existed prior to revised Article 9, but was intended to be bolstered by revised Article 9. See, e.g., *In re Summit Staffing Polk County, Inc., 305 B.R. 347, 354 (Bankr. M.D. Fla. 2003)*: "Revised Article 9 requires more accuracy in filings and places less burden on the searcher to seek out erroneous filings. The revisions to Article 9 remove some of the burden placed on searchers under the former law and do not require multiple searches using variations on the debtor's name."

G. Conclusions

None of the non-uniform legislation reviewed by the Committee in this Memo presents a satisfactory solution and none addresses the primary problem revealed by the case law – that most debtor name cases before the courts have been the result of filer error. They all fail to address additional issues related to determining and providing a debtor's name, such as cultural naming norms, non-U.S. alphabets, etc. They all fail to consider sufficiently the burden they would impose on searchers, and they all ignore the impact of lack of uniformity. They are all poorly-drafted. Further study of the debtor name issue and possible solutions should be conducted on a national basis before any other non-uniform state legislation is adopted. Enactment of piecemeal legislation may serve to delay or hinder development and enactment of better solutions.

We turn from the criticisms of and concerns about the non-uniform legislation to consider potential alternative solutions. We have not completed our analysis and this memorandum does not purport to present a "silver bullet" solution. We have, at least tentatively, concluded that if there is going to be a driver's license-based solution, it should be a statutorily mandated sole source for a sufficient individual debtor name, rather than a safe harbor. Well-drafted, and providing answers to the questions raised above concerning the Texas statute, such a solution would provide substantially greater certainty than exists presently. This would be even more likely to be the case if it were accompanied by another change—a mandatory formatting specifying that a debtor's name, for filing purposes, consists of a given name, a middle initial (if the individual has a middle name) and a surname. This would combine a single source with a single format and dramatically reduce the uncertainty. This combined solution has particular attraction because there are many instances when the name on the driver's license is not the name generally used by the debtor in his or her daily life or even in executing legal documents. This is particularly true with respect to middle names, which are very likely to appear on driver's licenses (and even more the case on passports and birth certificates[58]) while often not part of the name by which the debtor is commonly known. We note that the 1040 federal income tax form and the federal customs declaration form ask for (and provide space only for) a middle initial, not a full middle name.

In all events, adoption of a solution should take into account the possibility that it might not become effective simultaneously throughout the country and must be accompanied by appropriate transition provisions and solutions to any priority problems and conflicts problems that might arise, and should also be accompanied by enhanced instructions in electronic filing programs and on the reverse side of paper forms, as well as user-education programs. Only after dealing with all of the foregoing can a well-informed judgment be made as to whether the benefits gained from a given solution exceed the costs involved.

We intend to continue to study this and other possible solutions (e.g., the development of a unique identifier) and hope to contribute further to the debate.

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[58] Birth certificates , of course, will not reflect subsequent changes, e.g., marriage, divorce, and judicial and non-judicial changes. They seem more suitable to establish identity of the person (although they lack a photo) than identification of the person's name. On the other hand, they may well be among the least vulnerable to fraudulent alteration and, typically, can be verified from official records.

GENERAL NOTE: Please also note that if and when legislation with respect to any of the matters discussed in this Memo is introduced in California, our Committee is obliged to complete certain formal procedures required by the State Bar of California before the Committee can communicate its views on such legislation. If we then elect to do so, the Committee will evaluate such proposed legislation at that time and provide such comments on it as we deem appropriate after those procedures have been completed.

EXHIBIT A

UNIFORM COMMERCIAL CODE 9-503 COMPARED TO TEXAS BUSINESS AND COMMERCE 9.503

(a) A financing statement sufficiently provides the name of the debtor:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the debtor's formation documents that are filed of public record in~~of~~ the debtor's jurisdiction of organization to create the registered organization and that show~~which shows~~ the debtor to have been organized, including any amendments to those documents for the express purpose of amending the debtor's name;

(2) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate~~;~~

(3) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) Provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlers; and

(B) Indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust;

(4) If the debtor is an individual, if the financing statement provides the individual's name shown on the individual's driver's license or identification certificate issued by the individual's state of residence; and

(5) In other cases:

(A) If the debtor has a name, only if the financing statement~~it~~ provides the individual or organizational name of the debtor; and

(B) If the debtor does not have a name, only if the financing statement~~it~~ provides the names of the partners, members, associates, or other persons comprising the debtor.

(b) A financing statement that provides the name of the debtor in accordance with Subsection (a) is not rendered ineffective by the absence of:

(1) A trade name or other name of the debtor; or

(2) Unless required under Subsection (a) (4)(B), names of partners, members, associates, or other persons comprising the debtor.

(c) A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.

(d) Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.

(e) A financing statement may provide the name of more than one debtor and the name of more than one secured party.

EXHIBIT B

UNIFORM COMMERCIAL CODE 9-503 COMPARED TO TENNESSEE SENATE BILL 3732

SENATE BILL 3732
By Bunch

AN ACT to amend Tennessee Code Annotated, Title 47, Chapter 9, Part 5, relative to secured transactions.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Section 47-9-503 is amended by deleting subsection (a) in its entirety and substituting instead the following:

(a) A financing statement sufficiently provides the name of the debtor:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the debtor's formation documents that are filed of public record in~~of~~ the debtor's jurisdiction of organization to create the registered organization and that show~~which shows~~ the debtor to have been organized, including any amendments to those documents for the express purpose of amending the debtor's name;

(2) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate~~.~~;

(3) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) It provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settler and additional information sufficient to distinguish the debtor from other trusts having one (1) or more of the same settlers; and

(B) It indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust~~.~~;

(4) If the debtor is an individual, only if the financing statement provides the individual's name shown on one (1) of the following:

(A) A state-issued driver's license or identification card issued in lieu of a driver's license;

(B) A birth certificate;

(C) A passport;

(D) A social security card; or

(E) A government-issued military identification card; and

(5) In other cases:

(A) If the debtor has a name, only if it provides the individual or organizational name of the debtor; and

(B) If the debtor does not have a name, only if it provides the names of the partners, members, associates~~,~~ or other persons comprising the debtor.

~~(b) A financing statement that provides the name of the debtor in accordance with subdivision (a) is not rendered ineffective by the absence of:~~

~~(1) A trade name or other name of the debtor.~~

~~(2) Unless required under subparagraph (B) of paragraph (4) of subdivision (a), names of partners, members, associates, or other persons comprising the debtor.~~

~~(c) A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.~~

~~(d) Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.~~

~~(e) A financing statement may provide the name of more than one debtor and the name of more than one secured party.~~

SECTION 2. Tennessee Code Annotated, Section 47-9-516(b)(3), is amended by deleting subsection (D) in its entirety and substituting instead the following:

(D) In the case of a record filed or recorded in the filing office described in § 47-9-501(a)(1)~~1~~, the record does not provide the name of the debtor and a sufficient description of the real property to which it relates;

SECTION 3. It is the legislative intent to create a broad safe harbor for the use of a debtor's name in any form permitted by this act. To this end, this act applies to any filings made both before and after May 1, 2008; provided, however, any filing made prior to May 1, 2008, that was validly filed but which does not conform to the requirements of this act shall continue to be valid and nevertheless benefit from the safe harbor created hereby and no amendment shall be required to conform to the requirements of this act.

SECTION 4. This act shall take effect May 1, 2008, the public welfare requiring it.

EXHIBIT C

UNIFORM COMMERCIAL CODE 9-506 COMPARED TO NEBRASKA LEGISLATIVE BILL 716

LEGISLATURE OF NEBRASKA
ONE HUNDREDTH LEGISLATURE
SECOND SESSION
LEGISLATIVE BILL 716

Introduced by Pahls, 31.
Read first time January 09, 2008
Committee: Banking, Commerce and Insurance

A BILL

FOR AN ACT relating to secured transactions; to amend section 2 9-506, Uniform Commercial Code, Reissue Revised Statutes 3 of Nebraska; to change provisions relating to the effect of errors and omissions in a financing statement; and to repeal the original section.

Be it enacted by the people of the State of Nebraska,

Section 1. Section 9-506, Uniform Commercial Code, Reissue Revised Statutes of Nebraska, is amended to read:

9-506 Effect of errors or omissions~~Substantial compliance with requirements~~.

(a) 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.

(b) Except as otherwise provided in subsection (c), a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 9-503(a) is seriously misleading.

(c) If a search of the records of the filing office under the debtor's correct name, or, in the case of a debtor who is an individual, the debtor's correct last name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 9-503(a), the name provided does not make the financing statement seriously misleading.

(d) For purposes of section 9-508(b), the "debtor's correct name" in subsection (c) means the correct name of the new debtor.

Sec. 2. Original section 9-506, Uniform Commercial Code, Reissue Revised Statutes of Nebraska, is repealed.

APPENDIX C

Text of 2008 Tennessee and Nebraska UCC Legislation

PUBLIC CHAPTER NO. 648
SENATE BILL NO. 3732
By Bunch
Substituted for: House Bill No. 3734
By Fincher, Sontany, Fitzhugh, Eldridge, Matlock

AN ACT to amend Tennessee Code Annotated, Title 47, Chapter 9, Part 5, relative to secured transactions.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Section 47-9-503, is amended by deleting subsection (a) in its entirety and substituting instead the following:

(a) A financing statement sufficiently provides the name of the debtor:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the debtor's formation documents that are filed of public record in the debtor's jurisdiction of organization to create the registered organization and that show the debtor to have been organized, including any amendments to those documents for the express purpose of amending the debtor's name;

(2) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(3) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) Provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one (1) or more of the same settlors; and

(B) Indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust;

(4) If the debtor is an individual, only if the financing statement provides the individual's name shown on one (1) of the following:

(A) A state-issued driver license or identification card issued in lieu of a driver license;

(B) A birth certificate;

(C) A passport;

(D) A social security card; or

(E) A government-issued military identification card; and

(5) In other cases:

(A) If the debtor has a name, only if it provides the individual or organizational name of the debtor; and

(B) If the debtor does not have a name, only if it provides the names of the partners, members, associates or other persons comprising the debtor.

SECTION 2. Tennessee Code Annotated, Section 47-9-516(b)(3), is amended by deleting subsection (D) in its entirety and substituting instead the following:

(D) In the case of a record filed or recorded in the filing office described in § 47-9-501(a)(1), the record does not provide the name of the debtor and a sufficient description of the real property to which it relates;

SECTION 3. It is the legislative intent to create a broad safe harbor for the use of a debtor's name in any form permitted by this act. To this end, this act applies to any filings made both before and after May 1, 2008; provided, however, any filing made prior to May 1, 2008, that was validly filed but which does not conform to the requirements of this act shall continue to be valid and nevertheless benefit from the safe harbor created hereby and no amendment shall be required to conform to the requirements of this act.

SECTION 4. This act shall take effect May 1, 2008, the public welfarerequiring it.

PASSED: March 13, 2008

LEGISLATURE OF NEBRASKA
ONE HUNDREDTH LEGISLATURE
SECOND SESSION

LEGISLATIVE BILL 851

FINAL READING

Introduced by Banking, Commerce and Insurance Committee: Pahls, 31, Chairperson; Carlson, 38; Christensen, 44; Gay, 14; Hansen, 42; Langemeier, 23; Pankonin, 2; Pirsch, 4.

Read first time January 11, 2008

Committee: Banking, Commerce and Insurance

A BILL FOR AN ACT

. . .

Sec. 28. Section 9-506, Uniform Commercial Code, Reissue Revised Statutes of Nebraska, is amended to read:

9-506 Effect of errors or omissions.

(a) 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.

(b) Except as otherwise provided in subsection (c), a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 9-503(a) is seriously misleading.

(c) If a search of the records of the filing office under the debtor's correct name, or, in the case of a debtor who is an individual, the debtor's correct last name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 9-503(a), the name provided does not make the financing statement seriously misleading.

(d) For purposes of section 9-508(b), the "debtor's correct name" in subsection (c) means the correct name of the new debtor.

VERNON'S TEXAS SESSION LAW SERVICE 2007
Eightieth Legislature, 2007 Regular Session

Additions are indicated by Text; deletions by ~~Text~~. Changes in tables are made but not highlighted.

CHAPTER 565
S.B. No. 1540
FINANCING STATEMENTS AND OTHER RECORDS UNDER THE SECURED TRANSACTIONS LAW

AN ACT

relating to financing statements and other records under the secured transactions law.

Be it enacted by the Legislature of the State of Texas:

SECTION 1. Subsection (a), Section 9.503, Business & Commerce Code, is amended to read as follows:

<< TX BUS & COM § 9.503 >>

(a) A financing statement sufficiently provides the name of the debtor:

(1) if the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the debtor's formation documents that are filed of public record in ~~of~~ the debtor's jurisdiction of organization to create the registered organization and that show ~~shows~~ the debtor to have been organized, including any amendments to those documents for the express purpose of amending the debtor's name;

(2) if the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(3) if the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors; and

(B) indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust; ~~and~~

(4) if the debtor is an individual, if the financing statement provides the individual's name shown on the individual's driver's license or identification certificate issued by the individual's state of residence; and

(5) in other cases:

(A) if the debtor has a name, only if the financing statement provides the individual or organizational name of the debtor; and

(B) if the debtor does not have a name, only if the financing statement provides the names of the partners, members, associates, or other persons comprising the debtor.

SECTION 2. Subsection (b), Section 9.516, Business & Commerce Code, is amended to read as follows:

<< TX BUS & COM § 9.516 >>

(b) Filing does not occur with respect to a record that a filing office refuses to accept because:

(1) the record is not communicated by a method or medium of communication authorized by the filing office;

(2) an amount equal to or greater than the applicable filing fee is not tendered;

(3) the filing office is unable to index the record because:

(A) in the case of an initial financing statement, the record does not provide a name for the debtor;

(B) in the case of an amendment or correction statement, the record:

(i) does not identify the initial financing statement as required by Section 9.512 or 9.518, as applicable; or

(ii) identifies an initial financing statement whose effectiveness has lapsed under Section 9.515;

(C) in the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual that was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's last name; or

(D) in the case of a record filed or recorded in the filing office described in Section 9.501(a)(1), the record does not provide the name of the debtor and a sufficient description of the real property to which it relates;

(4) in the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;

(5) in the case of an initial financing statement or an amendment that provides a name of a debtor that was not previously provided in the financing statement to which the amendment relates, the record does not:

(A) provide a mailing address for the debtor;

(B) indicate whether the debtor is an individual or an organization; or

(C) if the financing statement indicates that the debtor is an organization, provide:

(i) a type of organization for the debtor;

(ii) a jurisdiction of organization for the debtor; or

(iii) an organizational identification number for the debtor or indicate that the debtor has none;

(6) in the case of an assignment reflected in an initial financing statement under Section 9.514(a) or an amendment filed under Section 9.514(b), the record does not provide a name and mailing address for the assignee;

(7) in the case of a continuation statement, the record is not filed within the six-month period prescribed by Section 9.515(d); or

(8) the record is not on an industry standard form, including a national standard form or a form approved by the International Association of Commercial Administrators, adopted by rule by the secretary of state.

SECTION 3. Section 9.517, Business & Commerce Code, is amended to read as follows:

<< TX BUS & COM § 9.517 >>

Sec. 9.517. EFFECT OF INDEXING ERRORS. The failure of the filing office to index a record or to correctly index information contained in a record does not affect the effectiveness of the filed record.

SECTION 4. Section 9.518, Business & Commerce Code, is amended by amending Subsection (a) and adding Subsection (d) to read as follows:

<< TX BUS & COM § 9.518 >>

(a) Any person named as a debtor or a secured party ~~A person~~ may file ~~in the~~

~~filing office~~ a correction statement with respect to a record ~~indexed there under the person's name~~ if the person believes that the record is inaccurate or was wrongfully filed.

(d) Filing of a correction statement is not effective as an amendment to a filed financing statement and is not sufficient to effect a change in the manner in which the filing office has indexed a financing statement or information contained in a financing statement.

SECTION 5. Section 9.705, Business & Commerce Code, is amended by amending Subsection (c) and adding Subsection (g) to read as follows:

<< TX BUS & COM § 9.705 >>

(c) The revision does not render ineffective an effective financing statement that, before the effective date of the revision, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in Section 9.103, as it existed immediately before the effective date of the revision. However, except as otherwise provided in Subsections (d), ~~and~~ (e), and (g) and Section 9.706, the financing statement ceases to be effective at the earlier of:

(1) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(g) Subsection (c)(2) does not apply to a financing statement that was filed before July 1, 2001, in the proper office in this state pursuant to Section 9.401, as that section existed immediately before July 1, 2001, and as to which the proper filing office was not changed pursuant to Section 9.501 of the revision. The lapse date of such a financing statement is the day when the financing statement would have ceased to be effective under Section 9.403(b), as that section existed immediately before July 1, 2001. On timely filing of a continuation statement within six months before that lapse date, the effectiveness of the financing statement continues for another period of five years commencing on the lapse date, and succeeding continuation statements may be filed within six months before the expiration of the five-year period and each additional five-year period to continue the effectiveness of the financing statement.

SECTION 6. This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect September 1, 2007.

Passed the Senate on April 19, 2007: Yeas 31, Nays 0; passed the House on May 17, 2007: Yeas 143, Nays 0, two present not voting.

Approved June 16, 2007.

Effective June 16, 2007.

TX LEGIS 565 (2007)

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