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SECURED TRANSACTIONS

State Legislatures Consider UCC Article 9 Amendments

In December 2008, we reported in this column about the formation by the Uniform Law Commission (also known as the National Conference of Commissions on Uniform State Laws) and the American Law Institute of a drafting committee to consider the first comprehensive set of changes to Article 9 of the Uniform Commercial Code since the amendments approved in July 1998 (which generally became effective in 2001).[1] That proposed package of changes was finalized 18 months later, in July 2010, and in January of this year formally presented to the states for consideration and adoption. Given that almost six months have elapsed since the launch of the legislative approval process for the 2010 amendments, we thought it an opportune time to review the progress of adoption of these amendments.

Introduction

The 1998 revisions were, in effect, a substantial overhaul of Article 9 and, accordingly, much more comprehensive than the 2010 revisions (66 new sections were added pursuant to the 1998 amendments, as compared to approximately 10 new sections in the 2010 amendments, and the entire article was reorganized). Since the 1998 revisions were so significant, they also presented worrisome conflict of laws issues were they not to be uniformly adopted by the proposed effective date. To address that concern, the drafters incorporated a delayed effective date of July 1, 2001, three years after finalization of the amendments. Nevertheless, although the sponsors were hopeful of nationwide effectiveness by the 2001 target date and allowed what they believed to be a sufficiently-lengthy period of time for adoption by the states, four states still had not adopted the 1998 revisions by the 2001 effective date.[2] It took until January of 2002 for the 1998 revisions to be effective in all 50 states plus the District of Columbia.

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The 2010 amendments contain a July 1, 2013 effective date, also providing a three-year period for adoption, consistent with the approach taken with the 1998 revisions. Given the new amendments are not nearly as substantial as the 1998 revisions, one may optimistically hope all states will have approved them by the 2013 effective date.

It is also important to monitor state variations which may result from the legislative process. In this case, as further discussed below, the 2010 amendments themselves present an important state variation, namely in regard to the correct name to use in filing financing statements against individual debtors.

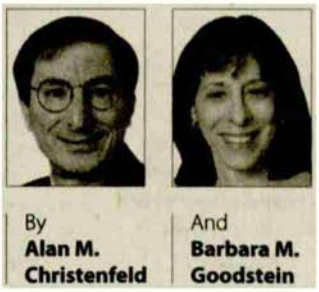
The 2010 Amendments

While the purpose of this article is report on the legislative adoption process and not to review the substance of this set of amendments, which has been covered extensively elsewhere, we will note briefly below a few of its highlights.

Perhaps the most important, and certainly most discussed, amendments in the 2010 revisions are the proposed changes regarding Section 9-503's financing statement filing requirements for individual debtors. The 2010 amendments present two alternative approaches, referred to as Alternative A and Alternative B, in regard to the correct individual debtor name on a financing statement. Indeed, given that this was the primary issue driving the amendment effort and engendered substantial debate, the drafters determined to offer up two options for greater guidance.[3] Each of these two options attempts to resolve the uncertainty concerning filing against individual debtors. Each focuses on the debtor's driver's license.

Alternative A follows a path described in various commentary as the "only if" approach. Under this approach, as set forth in proposed new Sections 9-503(a)(4) and (5), a financing statement filed against an individual with an unexpired driver's license is effective only if filed against the name indicated on such license. If the individual does not have an effective driver's license issued by the state where the financing statement is filed, then the secured party must file against either the debtor's "individual name" (the existing rule) or the surname and first personal name of the debtor, and is thus subject to the existing uncertainties under current law.[4]

Alternative B takes what has been described as the "safe harbor" approach. This approach provides three choices for the name



By **Alan M. Christenfeld** And **Barbara M. Goodstein**

to include in a financing statement filed against an individual debtor: (1) the "individual name" of the debtor, (2) the "surname and first personal name" of the debtor and (3) as in Alternative A, the name on the debtor's unexpired driver's license. Accordingly, Alternative A provides the unexpired driver's license as the only effective option (assuming one exists), whereas under Alternative B, the unexpired driver's license, is one of several effective options.

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A number of commentators have strongly endorsed Alternative A and publicly urged the states to adopt this alternative.[5]

There are many other notable changes included in the 2010 amendments. A new definition of "public organic record" has been added to clarify which records to use in determining the proper name for filing against a "registered organization." Further revisions to the definitions under Section 9-102 confirm that the term registered organization includes statutory trusts, limited liability companies, limited liability partnerships, as well as Massachusetts-type common law trusts (being trusts formed for business or commercial purposes which must file with the state a record, such as a trust agreement, in connection with but not as condition to formation). More- » Page 9 over, the definition of "certificate of title" will now encompass electronic records where such records are maintained by states in lieu of issuing title certificates.

New rules have been adopted in regard to filings on after-acquired property following a debtor's change of location or merger or consolidation and in regard to perfecting liens on electronic or hybrid (electronic and paper) forms of chattel paper. The amendments provide new commentary to overrule the unfortunate decisions of the Ninth Circuit and the New York State Court of Appeals, respectively, in the *Commercial Money Center*[6] and *Highland Capital Management v. Schneider* cases.[7] Regarding *Commercial Money Center*, the Official Comments now make it clear that if the lessor's rights to payment and leased goods are evidenced by chattel paper, then an assignment of the lessor's right to payment constitutes an assignment of the chattel paper (and not a sale of payment intangibles). Concerning *Highland Capital*, the commentary notes that a promissory note is not necessarily "investment property" under Article 9 simply because the issuer records or could record ownership or transfers thereof on its books or records.

Other revisions being effected by the 2010 amendments include clarifications as to the proper financing statement information when filing against trusts and trustees, allowing secured parties (rather than just debtors) to file "information statements" (formerly known as "correction statements"), and updating the uniform forms of initial financing statements and amendments. Some information currently required on financing statements, such as the type of organization, jurisdiction of organization and organizational identification number of a debtor, will no longer be necessary.

Progress of State Approvals

At deadline for submission of this article, seven states had adopted the 2010 amendments to Article 9.

North Dakota was the first state to enact these amendments, doing so on April 4, 2011. Indiana, Nebraska, Washington, Texas, Minnesota and, most recently, Nevada have followed suit. Notably, the state of Washington adopted Alternative B under 9-503(a) to the individual debtor name options. In addition, legislation implementing the 2010 UCC amendments has been introduced, but not yet adopted, in Connecticut, the District of Columbia, Massachusetts, Oklahoma and Rhode Island. In Connecticut, the proposed legislation contains the Alternative B safe harbor rule under 9-503(a); in each of the other states, the proposed legislation contains Alternative A. While most of the state legislatures have now adjourned or will shortly adjourn their regular legislative sessions for 2011, the larger commercial states (e.g., California, Illinois, New Jersey, New York, Massachusetts, Michigan, Ohio, Pennsylvania and Wisconsin) remain in session for most or all of the rest of the calendar year.

Although Kentucky was actually the first state in which the 2010 amendments cleared both chambers, the governor vetoed the legislation on March 16, 2011.[8] The governor's veto message was broad, vague and almost alarming, but the circumstances giving rise to the veto were apparently much narrower, the result of one proposed non-uniform provision, namely, a rule enabling tax lien filings to be made at the state rather than county level. This proposal, perhaps not surprisingly, engendered some unhappiness at county revenue offices and, when the I.R.S. also weighed in at the last minute, the governor decided to issue a veto. We understand a compromise has been worked out and the 2010 amendments will be re-proposed in January 2012.

Several themes are emerging with 2010 amendment legislative process. In response to the drafters' suggestions, all of the states that have adopted the 2010 amendments thus far, other than Nebraska, have added identification cards as alternatives to the driver's license under Alternative A (or, in the case of Washington, Alternative B).[9] Some of the references are more restrictive than others. For example, Indiana, Nevada and Texas provide that such identification cards must be issued in lieu of a driver's license. Washington, Minnesota and North Dakota, on the other hand, simply refer to any state-issued identification or identity card. More importantly, it also appears, based on the legislation adopted in Washington and, at deadline for this article, proposed in Connecticut, that Alternative A will not be the uniform approach for individual name filings among states adopting the 2010 amendments.

Another theme in regard to state variations relates to Section 9-521. This section establishes a safe harbor financing statement form which prohibits a state filing office from refusing to file such form if properly completed. In reviewing the safe harbor form in light of the 2010 amendments, the sponsors enlisted the help of the International Association of Commercial Administrators (IACA), the association of state filing officers. However, ultimately IACA, ULC and ALI could not agree on a new safe harbor form. Accordingly, the 2010 amendments contain textual language (but not an actual image

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form) which, if contained in a UCC financing statement, will prohibit the filing officer from refusing to accept such filing.

The reaction to this approach from several states has been to omit the proposed amendments to Section 9-521 entirely and potentially leave any form changes up to the individual state filing offices. Of the states which have adopted the 2010 amendments, Texas, Minnesota, Nevada and North Dakota have omitted the proposed amendments to Section 9-521; Indiana, Nebraska and Washington have included them.

Although states are certainly free to establish a different effective date than the one proposed by the 2010 amendment sponsors, all of the legislation proposed and approved thus far contains the uniform July 1, 2013 effective date.

As the amendments continue to make their way through the state legislatures, it is inevitable that other non-uniform variations will be included (note the discussion above regarding Kentucky). For example, the proposed Oklahoma legislation has added the affirmation "and a secured party has control of electronic paper" to the existing safe harbor for perfection by control of electronic chattel paper in 9-105(b), presumably to make it even clearer that a secured party has control if it either satisfies the newly added general rule (providing that a "secured party has control over electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned") or the safe harbor. The amendments adopted in Washington add a reference to "state-registered domestic partner" to the definitions of "Person related to" in Sections 9-102(a)(62) and (63).

Interestingly enough, while at deadline for submission of this article, the 2010 amendments have not been introduced in either Illinois or New York, both state legislatures have pending before them other UCC-related changes to state law, specifically, statutes which will provide additional remedies for fraudulent or otherwise wrongfully filed UCC financing statements (similar to non-uniform legislation previously enacted by Virginia and Michigan).

Transition Rules

Like the 1998 UCC amendments which became effective in 2001, the 2010 amendments contain transition rules in a new section in Article 9: Part 8.

As a threshold matter, under Section 9-803, a security interest perfected prior to the 2010 amendments is a perfected security interest under the 2010 amendments if the applicable requirements for attachment and perfection under the 2010 amendments are satisfied without additional further action. Section 9-805(a) further provides that a financing statement filed before the 2010 amendments is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under the 2010 amendments. So re-filings are not necessary if they are sufficient (and in the proper location) under the new rules.

5. See, id at 355 regarding the position of the American Bankers Association Working Group on UCC Article 9.

6. 350 B.R. 465, 481 (B.A.P., 9th Circuit 2006).

7. 8 N.Y. 3d. 406, 414-415 (2007).

8. The official "Veto Message From the Governor of the Commonwealth of Kentucky Regarding Senate Bill 143 of the 2011 Regular Session," dated March 16, 2011, stated as follows: "I am vetoing this bill because, while the measure contains many worthy provisions modifying our uniform commercial laws, it also contains sections that are inconsistent with federal law. These inconsistencies would adversely impact the operations and revenues of Kentucky's county clerks and county governments, and divert much needed revenue from the Affordable Housing Trust Fund."

9. See Legislative Note 3 to Section 9-503 in the Official Text, which states as follows: "Regardless of which Alternative is enacted, in states in which in which a single agency issues driver's licenses and non-driver identification cards as an alternative to a driver's license, such that at any given time an individual may hold either a driver's license or an identification card but not both, the state should replace each use of the term "driver's license" with a phrase meaning "driver's license or identification card" but containing the analogous terms used in the enacting state. In other states, the state should replace the term "driver's license" with the analogous term used in the enacting state.

Part 8 states, with one exception, that a security interest perfected under pre-amendment rules which would not be perfected under the new rules remains perfected for a period of one year following the 2010 amendment effective date, but will then lapse unless the new rules are complied with before the end of that one-year period. The one exception relates to security interests perfected by filing financing statements. If a financing statement filed prior to the effectiveness of the 2010 amendments would not be effective to perfect a lien on collateral under the 2010 amendments, the secured party has until the normal lapse of that financing statement (without regard to filing of a continuation statement) to either amend the financing statement so that it complies with the new requirements or, in the case of a financing statement which is not filed in the correct office or jurisdiction under the new rules, the earlier of normal lapse and June 30, 2018 to file an "in-lieu" initial financing statement in such correct office or jurisdiction.

A continuation statement for a pre-amendment effective date filing must generally follow the requirements of an initial financing statement. Accordingly, a continuation statement in an Alternative A state will have to contain the driver's license (or, as provided in certain states, other state identification card) name in order to be effective.

Finally, similar to the transition rules for the 1998 amendments, Part 8 provides that the 2010 amendments do not affect causes of action that commenced prior to the 2010 amendments effective date.

Conclusion

The amendment process to Article 9 was last experienced nationwide from 1998 to 2001. The amendments proposed during that time, as noted above, were much more comprehensive and presented much greater conflicts of law issues than the

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2010 amendments. Since the 2010 amendments are more limited than, do not present the substantial jurisdictional challenges of, and are relatively close in time to, the previous set of UCC revisions (possibly giving legislatures the benefit of some previous familiarity and experience), one may hope that this time around the amendment approval process will be relatively expeditious and non-controversial.

1. See, A. M. Christenfeld and S. W. Melzer, "First Modifications Since 2001 Considered for UCC Article 9," 240 NYLJ, No. 106, Dec. 4, 2008.

2. Alabama, Connecticut, Florida and Mississippi were the last holdouts. Revised Article 9 became effective in Connecticut on Oct. 1, 2001, and in Alabama, Florida and Mississippi on Jan. 1, 2002.

3. See, Edwin E. Smith, "A Summary of the 2010 Amendments to the Official Text of Article 9 of the Uniform Commercial Code," Uniform Commercial Code Law Journal, Volume 42 #4 October 2010) at 351.

4. There are also conforming amendments to 9-502 which are only to be adopted if a state chooses Alternative A. (See the Legislative Note to 9-502 contained in the National Conference of Commissioners on Uniform state Laws, Amendments to Uniform Commercial Code Article 9 dated

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