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Prepping for the 2010 Amendments To Article 9 of the UCC

As many readers are aware, substantial revisions to Article 9 of the Uniform Commercial Code (UCC) became effective in all 50 states and the District of Columbia in 2001 or shortly thereafter.[1] Although these amendments have worked well and simplified commercial law and practice in important respects, enough ambiguities and frictions between theory and practice have arisen over the past decade to justify statutory fine tuning. Accordingly, in 2008, the Uniform Law Commission (ULC) and the American Law Institute (ALI) set to work on evaluating and improving Article 9. A set of amendments which were completed in May 2010 by the ULC and the ALI ("2010 amendments") reflecting these efforts are ready for consideration by state legislatures. This article will discuss some of the troublesome issues that prompted the work of these commercial law grandees and the solutions contemplated by the 2010 amendments.

Debtor Name

The notice filing system lies at the bedrock of Article 9. As financing statements are indexed by debtor name, using the correct debtor name on the financing statement is the key to perfection in this system. In the language of the statute, a financing statement is effective only if it "provides the name of the debtor."[2]

The current version of the UCC includes a safe harbor under which a financing statement is effective notwithstanding minor errors or omissions so long as such errors or omissions are not seriously misleading.[3] Errors and omissions are not seriously misleading if a search under the "debtor's correct name," using the "filing office's standard search logic," would disclose the financing statement notwithstanding the errors or omissions.[4] The UCC does not define "search logic," and search logics are not uniform across jurisdictions. As a result, this safe harbor may or may not save the day for a secured party which misapprehends, or misuses, the debtor's name.

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Individual Debtors

A major source of litigation under the current UCC[5] revolves around the surprisingly elusive question of what is the "correct name" of an individual debtor for purposes of a financing statement.[6] The current UCC provides, somewhat tautologically, that "A financing statement sufficiently provides the name of a debtor... only if it provides the...name of the debtor."[7] Importantly, this rule does not clarify whether a nickname is sufficient or whether the failure to include a middle name or initial will render a financing statement ineffective.

Consider an individual debtor known as Harry Truman. Is the correct first name of such debtor "Harrison" or "Harry"? Does the debtor have a middle name? If the individual claims that his full and correct middle name is "S" (i.e., period omitted), would a financing statement filed against "Harry S. Truman" (i.e., period included) be ineffective? Further, what is the source of an individual debtor's name: a birth certificate, passport, driver's license, Social Security card—or all (or none) of the above?

The 2010 amendments include a new individual name rule that will increase legal certainty and reduce transaction costs and litigation risk by removing, or at least decreasing, legal uncertainty in this area. Due to disagreement about the precise form the remediation should take, two rules have been served up on the legislative buffet: (i) the "only if" approach (Alternative A) and (ii) the "safe-harbor" approach (Alternative B).[8]

Under the "only if" approach, if the debtor is an individual to whom the state in which he has his principal residence has issued an unexpired driver's license, the name of the individual as shown on his driver's license must be used on the financing statement. If an individual debtor does not have such a driver's license, the financing statement must indicate (1) the debtor's "individual name" (which term is not defined and essentially represents a default to the rule under the current UCC) or (2) the debtor's surname and first personal name.

The "safe-harbor" approach, on the other hand, has three sub-alternatives under which the name on the financing statement will be sufficient. First, use of the debtor's "individual name" (which, again, is the rule under the current UCC). Second, use of the debtor's surname and first personal name. And, finally, use of the name on the debtor's driver's license. This rule is agnostic regarding which alternative is employed.

Further, it is critical to understand that the "safe-harbor" approach is a perfection, and not a priority, rule. That is, a secured party that uses any of the three debtor name alternatives described in the previous paragraph will have priority under the "first-to-file-or-perfect" rule relative to a later secured party, irrespec- » Page 8

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Both approaches have potential advantages and disadvantages. The principal virtues of the "only if" approach are simplicity and certainty. The secured party will only need to identify one name when filing and searching. On the other hand, reliance on a driver's license is not a panacea. For example, a driver's license may expire, or the holder may have a new driver's license issued in another name.

The "safe-harbor" approach avoids the potential pitfalls involved by exclusive reliance on the driver's license and affords flexibility to filers. However, it creates a priority conundrum: a diligent secured party will need to search under all three debtor name alternatives, with the guesswork that inevitably attends determining the debtor's "individual name" and surname and first personal name.

Neither alternative addresses all potential individual debtor name issues, however. Consider, for example, the problem that arises when the debtor's name derives from a language using characters that can be transliterated in different ways (e.g., is the correct name "Mao Tse Tung" or "Mao Zedong"?). Prudent creditors will be constrained to continue searching and filing under multiple names.

Registered Entity Debtors

The current UCC provides concrete guidance regarding the correct name of a debtor that is a "registered organization," such as a corporation, limited partnership or limited liability company. Nevertheless, doubt has arisen about the exact source for determining such correct name. The "correct name" of a registered entity is "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."[9] The problems are, first, determining what constitutes the "public record" and, second, determining which record controls where there is more than one such record.

The 2010 amendments address both points. First, they create a new definition: "public organic record," which means "a record initially filed with or issued by a State or the United States to form or organize an organization jurisdiction."[10] This definition excludes other public records or indexes maintained by jurisdictions, such as good standing certificates or indexes of domestic corporate entities.

The 2010 amendments also establish rules for determining which "organic public record" controls. If there is more than one such record, the most recently filed record controls, and where there are multiple references within the applicable record, the reference that is identified as indicating the name of the debtor controls.

The 2010 amendments also add a new sentence to the definition of "registered organization,"[11] to make it clear that statutory trusts are included in the definition: "The term [i.e., 'registered organization'] includes a business trust that is formed or organized under the laws of a single State if a statute of the State governing business trusts requires that the business trust's organic record be filed with the State."

This clarification is consistent with the expectation of the market under the current UCC.

Electronic Chattel Paper

The current UCC includes a category of collateral termed "electronic chattel paper." Perfection in such collateral can be obtained by filing or by control.[12] The concept of "control" with respect to electronic chattel paper under the current UCC requires the satisfaction of several particular elements, compliance with which (or even comprehension of which) is difficult. For example, "control" of chattel paper requires that "it be a physical impossibility (or sufficiently unlikely or implausible so as to approach practical impossibility) to add or change an identified assignee without the participation of the secured party."[13] The practices that satisfy this high standard are unclear, and the inability to predict whether a specific practice satisfies this requirement impedes the development of such practices.

The 2010 amendments effectively conform this concept of "control" to that adopted in Article 7 of the UCC with respect to electronic certificates of title.[14] The new approach retains the standard under the current UCC as a "safe harbor"; that is, if a secured party satisfies the particular elements required for "control" under the current regime, it will be perfected by control.[15]

In addition, the 2010 amendments include a general test to establish "control," under which a "secured party has control 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."[16] Although an official comment to the 2010 amendments explains that the concept of reliability is a high standard, encompassing the general principles of uniqueness, identifiability and unalterability found in the "safe harbor" test, it does not state strict guidelines as to how these principles must be realized. It is hoped that the proposed amendments would provide the market with the flexibility needed to develop technologies and practices adequate to convey "control" of such collateral.

Finally, a new comment has been added to Section 9-330 that will provide comfort to certain secured parties with respect to chattel paper that is comprised of records partly in tangible form and records partly in electronic form. In particular, as long as the secured party has possession of the tangible chattel paper and

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control over the electronic chattel paper, it will qualify for the superpriority afforded by this section.

Payment Stripping

The court in *In re Commercial Money Center Inc.* 350 B.R. 465 (2006) wrestled with the issue of whether payment streams "stripped" from leases that constitute "chattel paper" retain their status as chattel paper or assume independent status as "payment intangibles." In an often criticized holding, the court determined that these payment streams are payment intangibles. The upshot of this holding is that the sale of such stripped rights are perfected without further action by the secured party, because sales of payment intangibles are automatically perfected.[17]

A comment to the 2010 amendments carries the day for the critics of the Commercial Money Center. Specifically, the new comment indicates that "if a lessor's rights under a lease constitute chattel paper, an assignment of the lessor's right to payment under the lease also would be an assignment of chattel paper, even if the assignment excludes other rights."[18] Thus, for an assignment of payment streams under a lease to be effective, the UCC rules regarding attachment and perfection of a security interest in the property generating such payment streams must be adhered to.

Foreclosure Clarifications

Sections 9-406(d) and 9-408(a) and (d) of the current UCC address the effect of contractual provisions that purport to prohibit, restrict or condition the assignment or grant of a security interest in, among other types of collateral, promissory notes and payment intangibles. Section 9-406(d) applies to a conventional pledge, while Sections 9-408(a) and (d) apply to a sale of a promissory note or a payment intangible (Sections 9-406(e) and 9-408(b)).

Both sections provide that the grant of a security interest or sale, as the case may be, is effective and can be perfected notwithstanding the underlying prohibition or restriction on assignment. They differ, however, in one respect that is important to foreclosing secured parties: While Section 9-406(d)(1) expressly safe-harbors enforcement of the security interest, Section 9-406(d) provides that if the prohibition or restriction is enforceable under law other than the UCC, the assignee cannot enforce directly against the account debtor.

Although this bifurcated approach likely was not developed with foreclosure sales in mind, its upshot is that a purchaser at such a sale or a secured party exercising the remedy of strict foreclosure could be unable to enforce its rights against the obligor or account debtor.

To address the concern, the 2010 amendments change Sections 9-406 and 9-408 to specify that they do not apply to foreclosure sales or strict foreclosures.[19]

In addition, the 2010 amendments add new language to a comment to current UCC Section 9-610 which explains that Internet foreclosure sales are allowed under the UCC.[20]

Transition Provisions

The 2010 amendments have an effective date of July 1, 2013.[21] Similar to the transition rules under the current UCC, the revised UCC, subject to the exceptions described below, applies to transactions entered into prior to the effective date.[22] However, the 2010 amendments will not affect any action, case, or proceeding commenced prior to the effective date.[23]

In addition, the 2010 amendments include grandfather clauses. In general, a security interest that is perfected under the current UCC but does not meet the requirements for perfection under the revised UCC will remain for one year after the effective date.[24] Unless the applicable perfection requirements are satisfied within the one-year period, perfection will lapse.

In the case of perfection achieved by filing a financing statement that satisfies the requirements of the current UCC but does not satisfy the requirements of the revised UCC (e.g., a financing statement that identifies the debtor as "Jon Smith," where name on the driver's license is "Jonathan Smith"), the 2010 amendments provide that the financing statement will remain effective until the earlier of (x) the time such financing statement would have lapsed under the current UCC or (y) June 30, 2018.[25] The secured party can maintain perfection by amending the name of the debtor when it files a continuation statement.

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