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Survey--Uniform Commercial Code

THE UNIFORM COMMERCIAL CODE SURVEY: INTRODUCTION

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The Survey that follows highlights the most important and interesting judicial decisions of 2009 dealing with domestic and international sales of goods, personal property leases, payments, letters of credit, documents of title, investment securities, and secured transactions. Also of some note are the legislative developments. Specifically, the Joint Review Committee for Article 9 completed its work and by the time this Survey is printed, the U.C.C. sponsors will likely have approved the changes proposed. In addition, the Study Committee on Payment Issues has continued to explore the prospect of overhauling payments law to better accommodate electronic transactions and harmonize the rules applicable to different payment mechanisms. Finally, the Uniform Law Commission began work on a new Uniform Certificate of Title for Vessels Act. That act is intended to bring uniformity to an area in which it is needed and to harmonize state certificate of title laws with both federal laws regarding vessels and Article 9, all in an effort to impede theft and facilitate boat financing.

The payments and vessel titling projects are still a long way from completion, and preliminary information about them is available online. [FN1] The revisions to Article 9 are now complete, [FN2] and are summarized below.

REVISIONS TO ARTICLE 9

PERFECTION ISSUES

1. Article 9 currently provides that the name of a registered organization is the name indicated on the public record of the jurisdiction of organization. [FN3] Unfortunately, in some states the name listed on the debtor's organizational documents--e.g., its articles of incorporation--may not perfectly match the name entered in the state's electronic database of names of registered organizations. The differences may result from error during entry of the name or from a limitation on the size of the name field in the database. To deal with this, a new defined term has been created: “public organic record,” [FN4] and the name of the registered organization will be the name stated to be the debtor's name on the document filed with or issued by the state to form the registered organization, not the name in the electronic database. [FN5]

2. Much of the Joint Review Committee's deliberations concerned the name of an individual debtor. There have been roughly a dozen published decisions about what an individual debtor's name is. While the decisions reveal no great confusion among the courts, [FN6] several states have enacted non-uniform amendments to deal

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with the perceived uncertainty about the correct name of an individual. [FN7] To stem the tide of non-uniform amendments, the Joint Review Committee was compelled to act. Unable to reach consensus on a single plan, the Committee proposed giving states two alternatives from which to pick. [FN8] Alternative A, known as the "only-if" rule, requires filers to use the name on the debtor's driver's license, if the license has not on its face expired and the license is issued by the state in which the debtor is located. If the debtor does not have such a driver's license, the filer must use either the individual name of the debtor (i.e., whatever the debtor's name is under current law) or the debtor's surname and first personal name. [FN9] Alternative B, known as the "safe harbor" rule, leaves intact the requirement that the financing statement use the debtor's "individual name," but provides that the name on the driver's license will also be sufficient. If the debtor does not have a current driver's license issued by the state in which the debtor is located, using the debtor's surname and first personal name will be sufficient. [FN10]

The amendments make a correlative change to section 9-507(c), altering its voice from active to passive. Instead of dealing with situations in which "a debtor changes its name," the provision will apply whenever the name of the debtor changes. [FN11] This was done to make clear that a change in an individual debtor's driver's license might qualify as a name change. [FN12]

3. If collateral is held in trust, there may be uncertainty as to whether the debtor is the trustee or the trust itself. This makes identifying the name of the debtor in a financing statement somewhat difficult. To simplify this, the amendments provide that if the collateral is held in a trust that is a registered organization, the name of the registered organization should be used as the name of the debtor. [FN13] If the trust is not a registered organization, the financing statement must (i) provide as the name of the debtor the name specified as the name of the trust in the trust's organic record; or (ii) if the trust's organic records do not specify the name, the name of the settlor or testator and additional information sufficient to distinguish the trust from other trusts having the same settlor or testator. In either case, the financing statement must also indicate that the collateral is held in trust. [FN14]

4. Article 9 currently provides that perfection by filing continues for four months after the jurisdiction in which the debtor is located changes. [FN15] However, this temporary period of perfection applies only with respect to collateral owned by the debtor at the time of the change. Even if the security interest attaches to after-acquired collateral, there is currently no perfection with respect to such new collateral unless and until the secured party perfects pursuant to the law of the new jurisdiction. The amendments change this by giving the filer perfection for four months in collateral acquired post-move. [FN16] A similar change is made with respect to a new debtor: that is, a successor by merger. The new rule provides for temporary perfection in collateral owned by the successor before the merger or collateral acquired by the successor within four months after the merger. [FN17]

5. Article 9 authorizes the filing office to reject a financing statement that identifies the debtor as an organization if the financing statement fails to indicate (i) what type of organization the debtor is; (ii) the jurisdiction of organization; or (iii) the debtor's organizational identification number (or indication that the debtor has none). [FN18] Because the Committee concluded that this information serves no real purpose, the amendments delete the authorization to reject a financing statement that omits any of this information. [FN19]

6. Article 9 requires that a filed financing statement be authorized by the debtor, although it also provides that by authenticating a security agreement the debtor in fact authorizes the secured party to file a financing statement that describes the collateral listed in the security agreement. [FN20] Article 9 also expressly author-

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izes a secured party to file a financing statement before the security agreement is executed or the security interest attaches. [FN21] These rules are in some tension with each other when a prospective lender files a financing statement without the debtor's authorization and the debtor later accepts a loan and authenticates a security agreement, thereby authorizing the filing. Does the later authorization have retroactive effect? The common law of agency normally prohibits a retroactive ratification from impairing the rights of any third party that arose prior to the ratification, [FN22] and thus suggests that retroactive authorization could, at best, make the filer's priority date the moment of authorization, not the earlier time of filing. However, a rather cryptic comment to section 9-509 indicates that the priority issue is governed by Article 9, not by other things, such as the law of retroactive ratification. [FN23] The amendments add a new comment to section 9-322, the provision dealing with priority among competing secured parties, to make it even more clear a financing statement that was unauthorized when filed but which is subsequently authorized is as effective as if authorized when filed. [FN24] As the comment explains, because the notice function of a financing statement is served regardless of whether the financing statement was authorized when filed, subsequent authorization makes the financing statement fully effective from the date filed.

7. The amendments substantially modify the standard for control of chattel paper, to make it comport with section 16 of the Uniform Electronic Transactions Act. The new standard is whether "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." [FN25] The current standard will become a safe harbor. [FN26]

ENFORCEMENT ISSUES

8. Section 9-406(d) contains a broad override of contractual restrictions on assignment of receivables. Section 9-408(a) contains a similar, but narrower, override; it makes the assignment effective but leaves the assignee with no direct ability to enforce the assigned receivable against the account debtor or other obligor. The broader rule applies to security interests that secure an obligation if the receivable assigned is an account, chattel paper, payment intangible, or promissory note. [FN27] It also applies to sales of accounts and chattel paper. The narrower rule applies to sales of payment intangibles and promissory notes. [FN28] Unfortunately, what remains unclear under current law is which rule applies if a payment intangible or promissory note secures an obligation and the secured party forecloses by selling it or by conducting a strict foreclosure. The amendments make it clear that the broader restriction applies. [FN29] That is, if the underlying transaction was subject to the broader restriction, then any enforcement of the security interest is also subject to the broader restriction.

9. Section 9-607 authorizes the secured party to collect on the collateral after default. [FN30] If the collateralized receivable is secured by a mortgage on real property, and applicable law allows the mortgage to be foreclosed upon non-judicially, section 9-607 also authorizes the secured party to proceed non-judicially if it provides a sworn affidavit in recordable form stating that "a default has occurred." [FN31] Unfortunately, that phrase is ambiguous: it could mean a default on the secured obligation or a default on the mortgage obligation. The amendments add language to make clear it means a default on the mortgage obligation. [FN32] A Reporter's Note adds that this was what the original language has always meant and thus this does not represent a change in the law. [FN33]

10. Article 9 requires that the secured party normally send notification of the time and place of any planned public disposition of the collateral. [FN34] It is not entirely clear what is required in the context of an internet auction. [FN35] The amendments add a comment that a notification satisfies the statutory standard if it "states

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the time when the disposition is scheduled to begin and states the electronic location." [FN36]

OTHER ISSUES

11. The amendments modify the definition of "certificate of title" to include electronic certificates maintained by the issuer as an alternative to a paper certificate. [FN37]

12. Section 9-518 authorizes the debtor to file a correction statement: a claim that a financing statement filed against it was in fact unauthorized. [FN38] The correction statement has no legal effect, but it does put in the public record the debtor's claim that the financing statement was wrongfully filed. The amendments change section 9-518 in several ways. First, to avoid any suggestion that such a statement has legal effect, it is no longer called a "correction statement," but is instead referred to as an "information statement." [FN39] Second, the amendments authorize the secured party of record to file an information statement. [FN40] The reason for this is that while the debtor may wish to inform people that a financing statement was unauthorized, the secured party may want to inform people that an amendment or termination statement was unauthorized. The comments make clear that the secured party has no duty to file an information statement, even if it knows of the unauthorized filing. [FN41]

13. A few years ago, the decision in *In re Commercial Money Center, Inc.* [FN42] set off a wave of controversy. The court in that case indicated that a lessor's right to payment on chattel paper leases, if stripped off and assigned, would not be chattel paper. [FN43] The amendments add a comment expressly disavowing the court's opinion on this issue. [FN44]

14. The old version of Article 9 applied to "any transaction (regardless of its form) which is intended to create a security interest in personal property." [FN45] The drafters of revised Article 9 purposefully omitted the reference to intent in an effort to signal that the economic substance of the transaction is what matters. To make this even clearer, the amendments insert in the comment the statement that: "the subjective intention of the parties with respect to the legal characterization of their transaction is irrelevant to whether this Article applies." [FN46]

15. Two years ago, the New York Court of Appeals issued its notorious ruling in *Highland Capital Management LP v. Schneider*. [FN47] In that case, the court held that a series of privately issued promissory notes were "securities"--and therefore a contract to sell them was exempt from the statute of frauds in the prior version of Article 1--because they *could have* been registered on the books and records of the issuer. [FN48] The decision is simply wrong and a new comment expressly so states. [FN49]

EFFECTIVE DATE

The amendments are slated to have a uniform effective date of July 1, 2013. [FN50]

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[FN1]. *See* Gonzaga University School of Law, Commercial Law Center, http:// www.law.gonzaga.edu/Centers-Programs/commercial_law_center/links_resources.asp (last visited May 27, 2010).

[FN2]. *See* JOINT REVIEW COMM. FOR ARTICLE 9 OF THE UNIF. COMMERCIAL CODE, UNIFORM COMMERCIAL CODE ARTICLE 9, SECURED TRANSACTIONS, TENTATIVE DRAFT NO. 1 (Apr. 1, 2010), *available at* http:// www.law.upenn.edu/bll/archives/ulc/ulc.htm#ucc9 [hereinafter "Proposed Amendments"].

[FN3]. U.C.C. § 9-503(a)(1) (2008).

[FN4]. *See* Proposed Amendments § 9-102(a)(67A).

[FN5]. *See* Proposed Amendments § 9-503(a)(1), (f).

[FN6]. For example, two cases involved misspellings which rendered a filed financing statement ineffective. *See In re* Fuell, No. 06-40550, 2007 WL 4404643 (Bankr. D. Idaho Dec. 13, 2007) (spelling the debtor's last name "Fuel" instead of "Fuell"); Pankratz Implement Co. v. Citizens Nat'l Bank, 130 P.3d 57 (Kan. 2006) (listing the debtor's first name as "Roger" instead of "Rodger"). Similarly, several others involved a financing statement that used a nickname or shortened version of an individual debtor's name. The clear consensus of these cases is that this too is ineffective. *See In re* Kinderknecht, 308 B.R. 71 (BAP 10th Cir. 2004) ("Terry J. Kinderknecht" instead of "Terrance Joseph Kinderknecht"); *In re* Larsen, No. 09-00219-lmj7, 2010 WL 909138 (Bankr. S.D. Iowa Mar. 10, 2010) ("Mike D. Larsen" instead of "Michael D. Larsen"); *In re* Jones, No. 05-16909, 2006 WL 3590097 (Bankr. D. Kan. Dec. 7, 2006) ("Chris Jones" instead "Christopher Gary Jones"); *In re* Borden, 353 B.R. 886 (Bankr. D. Neb. 2006) ("Mike Borden" instead of "Michael R. Borden"), *aff'd*, No. 4:07CV3048, 2007 WL 2407032 (D. Neb. Aug. 20, 2007); *In re* Berry, No. 05-14423, 2006 WL 2795507 (Bankr. D. Kan. Sept. 26, 2006), *opinion supplemented*, 2006 WL 3499682 (Dec. 1, 2006) ("Mike" instead of "Michael"). *But see* Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549 (5th Cir. 2007) ("Louie Dickerson" instead of "Brooks L. Dickerson" was effective because the debtor held himself out to the community as Louie Dickerson and frequently used his nickname in business affairs).

[FN7]. Tennessee, Texas, and Virginia all made the name on the debtor's driver's license a safe harbor. TENN. CODE ANN. § 47-9-503(a)(4) (Supp. 2009); TEX. BUS. & COM. CODE ANN. § 9.503(a)(4) (Vernon Supp. 2009); VA. CODE ANN. § 8.9A-503(a)(4) (Supp. 2009). Nebraska took a different approach. It amended its version of section 9-506(c) to provide that an error in the debtor's name is not seriously misleading if a search under the debtor's correct *last* name reveals the filing. *See* NEB. REV. STAT. U.C.C. § 9-506(b) (Supp. 2008). More recently, however, it delayed the effective date of this new rule to give the Code's sponsoring organizations more time to craft a uniform solution to the problems surrounding uncertainty about an individual debtor's name. *See id.* § 9-506.

[FN8]. *See* Proposed Amendments § 9-503(a)(4), (5), (6).

[FN9]. *Id.*

[FN10]. *Id.*

[FN11]. *See id.* § 9-507(c).

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[FN12]. *See id.* § 9-503 Reporter's Note.

[FN13]. *See id.* § 9-502(a)(1).

[FN14]. *See id.* § 9-503(a)(1), (3).

[FN15]. *See* U.C.C. § 9-316(a)(2) (2008).

[FN16]. *See* Proposed Amendments § 9-316(h).

[FN17]. *See id.* § 9-316(i). *See also id.* § 9-326(a), (b) (preserving the priority of creditors who filed against the new debtor by subordinating the security interest of those creditors who are perfected only by a filing against the original debtor).

[FN18]. *See* U.C.C. § 9-516(b)(5) (2008).

[FN19]. Proposed Amendments § 9-516.

[FN20]. U.C.C. § 9-509(a), (b) (2008).

[FN21]. *See id.* § 9-502(d).

[FN22]. *See* RESTATEMENT (THIRD) OF THE LAW OF AGENCY § 4.02 (2006).

[FN23]. U.C.C. § 9-509 cmt. 3 (2008).

[FN24]. Proposed Amendments § 9-322 cmt. 4.

[FN25]. *See* Proposed Amendments § 9-105(a).

[FN26]. *See id.* § 9-105(b).

[FN27]. *See* U.C.C. § 9-406(d)(1), (2) (2008).

[FN28]. *See id.* § 9-408(a), (d).

[FN29]. Proposed Amendments § 9-406.

[FN30]. U.C.C. § 9-607(a) (2008).

[FN31]. *Id.* § 9-607(b)(2).

[FN32]. Proposed Amendments § 9-607(b).

[FN33]. *Id.* § 9-607 Reporter's Note.

[FN34]. *See* U.C.C. §§ 9-611(b), 9-613(1)(E) (2008).

[FN35]. *See* Michael Korybut, *Online Auctions of Repossessed Collateral Under Article 9*, 31 RUTGERS L.J. 29 (1999). *See also* Moore v. Wells Fargo Constr., 903 N.E.2d 525, 533 (Ind. Ct. App. 2009) (notification of a public internet sale that includes the web address of the auction and the physical address of the auction company

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satisfies the requirement that it identify the location of the sale).

[FN36]. Proposed Amendments § 9-613 cmt. 3.

[FN37]. *Id.* § 9-102(a)(10).

[FN38]. *See* U.C.C. § 9-518 (2008).

[FN39]. Proposed Amendments § 9-518.

[FN40]. *Id.*

[FN41]. *Id.* § 9-518 cmt. 2.

[FN42]. 350 B.R. 465 (9th Cir. BAP 2006).

[FN43]. *See id.* at 480-81.

[FN44]. Proposed Amendments § 9-102 cmt. 5d.

[FN45]. U.C.C. § 9-102(1)(a) (1997) (superceded).

[FN46]. Proposed Amendments § 9-109 cmt. 2.

[FN47]. 8 N.Y.3d 406 (2007).

[FN48]. *See id.* at 411-16.

[FN49]. Proposed Amendments § 8-103 cmt. 9.

[FN50]. *Id.* § 9-801.
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