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THE UCC: CURRENT AND COMING CHANGES

by

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Begun in the 1950's with the objectives of updating the common law and providing uniformity throughout all American jurisdictions for commercial transactions, the Uniform Commercial Code ("the Code") is now a given in American jurisprudence. Business interests and consumers have flourished in the years since the Code's inception and to keep the law current, parts of it have been amended in 1962, 1966, 1972, 1977, and 1987. Today the Code is being revised again with objectives similar to those of the original drafters. The National Conference of Commissioners on Uniform State Laws and the American Law Institute have proposed substantial changes to the Code with a proposed effective date of July 1, 2001. To date, seven states have passed the revisions and virtually all states will be considering adoption.

Article 9 which governs secured transactions is the area of greatest emphasis in the Revised Code. The drafters enlarge the types of collateral which may be the subject of a secured transaction and attempt to make the article more user friendly by incorporating modern business practices into the statute. Just as the original UCC modified and updated the common law, the Revised Code makes changes to the present UCC in important areas such as attachment, perfection, filing requirements, and priorities of secured parties. The body of this paper will focus on the important Article 9 changes, the first general revision of that article since 1972, set forth in the Revised Code. All statutory references herein to the Code will refer to the Revised Code unless otherwise stated.

Attachment

The most fundamental concept of secured transactions is attachment. Indeed, attachment involves the creation of the security interest. Section 9-203(a) provides, "A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral." Current law provides that for the security interest to attach the debtor must sign a security agreement which contains a description of the collateral or the collateral must be in the possession of the secured party. This rule is modified by Section 9-203(a) which allows for authentication of the security agreement by the debtor. The concept of authentication recognizes and incorporates modern business practices, e.g., e-mail and fax, as appropriate indications of assent to Article 9 transactions. A debtor need not sign a security agreement. A security agreement may be signed by the debtor, but other appropriate electronic means of authenticating the assent of the debtor to the transaction are permissible. Revised Article 9 does not limit the concept of authentication to security agreements. Section 9-102(a)(7) states that to authenticate means to sign or "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." As the business world has moved to means of indicating assent other than by signing paper, the Code has embraced these means of authentication as well. In this regard, the Revised Code is said to be "medium neutral" recognizing authenticated records, i.e., information contained in a medium that can be retrieved in understandable manner or way.

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As an alternative to a signed security agreement, a creditor could have, or be given, possession of the collateral pursuant to an agreement that the creditor have a lien or rights in the collateral. Although this is generally not done since the debtor commonly wants the use of the collateral, attachment by possession recognizes transactions such as a simple pledge or pawn shop transaction. The concept of possession is extended by the revisers to "control" for deposit accounts, electronic chattel paper, investment property, and letter-of-credit rights (Section 9-203(a)(3)(D)). Accordingly, one may create a security interest in favor of a creditor by granting control to the creditor by agreement. The concept of control is also important concerning perfection and allows for collateral hitherto governed by common law rules to come within the purview of Article 9. The widened scope of Article 9 and changed perfection rules will be discussed herein.

For a debtor to grant a security interest in collateral, the debtor traditionally had to have rights in the collateral. The theory was, of course, that a debtor could not grant a lien on collateral unless the debtor had some rights in the collateral on which to place the lien. The revisers also broaden somewhat the rights in collateral concept by providing that one with the power to transfer rights in the collateral to a secured party may also grant a security interest.

Disputes over the sufficiency of descriptions of collateral in security agreements have caused litigation. In Section 9-108 the revisers attempt to clarify the concept of reasonable identification by listing a number of safe harbor ways by which collateral may be reasonably described, including category and type of collateral as generally sufficient. Subsection (c), however, makes clear that a supergeneric description of "all the debtor's assets" or "all the debtor's personal property" does not sufficiently describe the collateral. Thus, a modest amount of specificity is required to alert the debtor as to the property upon which the lien will rest, but general descriptions are permissible. Additional specificity is also required for consumer transactions.

Changes in Filing Rules

For the great majority of secured transactions, perfection is achieved by the filing of a financing statement. The Revised Code introduces a number of rules to simplify and clarity filing issues.

Consistent with the overall concept of "medium neutrality," electronic filing will be permissible and the filing must take place at the place where the debtor is located. The debtor does not have to sign the financing statement, since consent to a security agreement is deemed to be consent to the filing of a financing statement consistent with the security agreement. Filings must take place at the location of the debtor (Section 9-301(1)). A debtor which itself comes into being by registration or filing, e.g., a corporation or limited liability company, is deemed located in the state of incorporation or registration (Section 9-307(d)). This modifies the current rule requiring filing at the place of the debtor's principal place of business or executive office. For a corporation doing business nationally or regionally, the appropriate place for filing financing statements is the state of incorporation of the debtor. A debtor who is an individual is "located" at the individual's principal residence (Section 9-307(1)). Filing at the location of collateral will hereafter be considered unnecessary. To encourage ease of filing and searching of financing statements, filing will be centralized in one location in each state except for filings of real estate fixtures which will still be filed locally (Section 9-501(a)(2)).

A great deal of litigation has centered on the contents of financing statements concerning questions of whether the debtor and/or collateral have been sufficiently identified. In an effort to foster clarity and avoid unnecessary litigation, the revisers have set forth relatively simple rules concerning the requirements for the contents of financing statements. Section 9-502(a) provides as the three essentials of a financing statement, the name of the debtor, the name of the secured party or a representative, and the collateral covered by the financing statement. A financing statement which fails to include the three required elements may be rejected for filing by the filing office, but there are only limited additional grounds for rejection thereby removing from the filing office the need to make filing decisions. Since entities frequently use trade names, a debtor which is a registered organization, e.g., a corporation, must be identified by the exact name on the public record of the place or organization. Identification by trade name alone is insufficient to properly identify the debtor. But minor errors in filing continue to be disregarded if they are not seriously misleading, and if a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic would disclose the name of the debtor, the name provided would not be deemed seriously misleading. Concerning descriptions of collateral, although prohibited in security agreements, a description of "all assets or all personal property" (Section 9-504) is expressly stated to be sufficient. In a further effort at standardization and simplification, Section 9-521 provides for national filing forms which the secured party may, but not must, use and which must be accepted by the filing office.

Broadened Scope and New Collateral

Even a casual observer of financial markets and financial transactions in general will realize that things that were previously not the subject of financial transactions have today had values assigned to them and become included in types of financial transactions that were hitherto unknown. Thus, in the twenty-first century we have loans and credit extensions being made on the bases of extremely varied collateral. Typically, creditors

will attempt to make new collateral the subject of secured transactions. The difficulty with these attempts was that much of the untraditional collateral was not within the purview of Article Nine. Since the collateral was not covered by the Code, creation of the liens was left to the laws of the various states leading to a lack of clarity and increased uncertainty for businesspersons. Uncertainty generally inhibits economic growth and leads to litigation. To remedy this situation, the Revised Code broadens the scope of collateral which may be the subject of Article Nine secured transactions.

Revised Article Nine as set forth in Section 9-109(a)(3) now covers deposit accounts when used as original collateral for a transaction as well as accounts, chattel paper, payment intangibles and promissory notes. In addition, health care receivables, agricultural liens, commercial tort claims, consignments and general intangibles are included by Section 9-109. Investment property and software may also be the subject of secured transactions governed by the Code. The inclusion of these new types of collateral has necessitated new and clarified rules for perfection. In many cases, the rules are simplified when compared to the varied rules prevailing in the various states.

Special Rules of Perfection and Priority

A creditor may perfect a security interest in a deposit account, e.g., a bank account, only by control. For determining control, the depositary institution must agree that the institution will follow the secured creditor's direction without the additional consent of the debtor or the account must be actually converted into the name of the secured creditor. Filing will not achieve control over the account. It should be noted, however, that the secured creditor may be considered in control of the account for secured transactions purposes despite the fact that the debtor has access to the account. In the case of the debtor having access to the funds, while the secured creditor may run the risk of the debtor withdrawing the funds, in the case of a bankruptcy of the debtor, the perfection by control would still be in effect.

Article Nine traditionally covered accounts, but the revisers expanded the definition in response to the heightened use of account financing. Accounts under the Revised Code will not be limited to payment obligations arising out of the sale or lease of goods, but by virtue of Section 9-102(a)(2) will include payment obligations arising out of the sale, lease, or license of all tangible and intangible property. This would include credit card receivables and the intellectual property rights which have become such an important part of today's financial transactions. Perfection in accounts may be accomplished by filing. Health care receivables are treated as accounts. To clarify the Code's recognition of account financing as being within Article Nine, by virtue of Section 9-406(d), terms restricting assignment in the agreement between the account debtor and the assignor are generally ineffective.

Consignments, except in the rare case of a consumer acting as consignor, are treated as purchase money security interests requiring the secured creditor to file to perfect its security interest. Failure to perfect the security interest would allow the creditors of the bailee to reach the collateral. Case law frequently held that the posting of a sign on the premises of the consignee-bialee would be sufficient notice, but this question is now clarified by the revision. Similarly a consignee of goods does not have to have true rights in collateral to grant a security interest in the goods since the expanded definition of attachment would encompass one who has the power to transfer rights in the collateral. Clearly the consignee has the power to transfer rights, hence the power to grant a security interest in the collateral. An unperfected security interest created by consignment would be subordinate to a security interest granted by the consignee which was perfected.

Investment property may be thought of as securities. With so much interest in securities of late, it is only reasonable that credit will be extended on the basis of investment property. Consistent with such extensions of credit will be creditors who will wish to securitize such transactions. A security interest in investment property may be perfected by filing or by control with the latter affording the greater protection. In addition to the traditional way of safeguarding the lien by having the debtor deliver the securities to the creditor with an appropriate indorsement, the parties may opt to give the creditor control of a securities entitlement by having a securities intermediary, e.g., a broker or transfer agent, agree that the intermediary will follow directions of the secured creditor without additional approval of the debtor (Section 9-314(a)) or by putting the securities account in the name of the secured party. Perfection by control is generally superior to perfection by filing (Section 9-328(1)).

Letter-of-credit rights also require control for perfection. Section 9-107 provides that control is established "if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under Section 5-114(c) or otherwise applicable law or practice." It is clear that perfection will always be dependent on the issuer of the letter of credit's consent. Accordingly, the stage is now set for those with letter-of-credit rights to use them as the source of financing in secured transactions.

Chattel paper, defined in Section 9-102(a)(11) as a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods or a lease of specific goods, may be the subject of a secured transaction. The interesting leap into the twenty-first century by the revisers is the recognition of electronic chattel paper. Of course, there can be no perfection by possession since there is nothing to possess, the electronic chattel paper being stored in an electronic medium. Perfection in electronic chattel paper may be accomplished by control or filing, but perfection by control is generally considered to have priority over one who has perfected by filing by virtue of Section 9-329(1). This priority rule is similar to the one for ordinary chattel paper which allows for perfection by filing or possession with the party who perfects by possession having priority over the one who perfects by filing alone.

Section 9-105 requires that for control of electronic chattel paper to be established there must be a single authoritative copy of the record which is unique, unalterable, and identifiable. The copy must identify the secured party and the copy must be maintained by the secured party. It may be challenging to find ways to electronically identify the

secured party on the one definitive copy of electronic party, but it is obvious that the revisers are aware that parties will attempt to use these types of collateral and are providing a consistent framework for their use.

Conclusion

Financing transactions have become more numerous and more complex as the twentieth century ends and the new millennium begins. Parties will always try to use new collateral to arrange financing. Collateral which ten or fifteen years ago was not contemplated as useful as the subject of secured financing is now being utilized in the fast paced and rapidly changing area of secured transactions. New collateral and speed of transactions inspired in large part by electronic advancements which are now considered commonplace in business are the subject of the changes in Article Nine. In general, it appears that the revisers have made an admirable attempt to make the laws which govern these new transactions both reasonable and uniform. Due respect seems to have been accorded by the revisers to need for speed and certainty in these newer type secured transactions. Although adoption is in an early stage, history tells us that approval is probable by the projected date of July 1, 2001, or some time relatively soon thereafter. It is likely that the revisions will become the law.