UNIFORM COMMERCIAL CODE COMMITTEE

REPORT PREPARED FOR THE DECEMBER 6, 2008 COUNCIL MEETING

1. Next Scheduled Meeting of the Committee.

Next scheduled meeting of the Committee: When Darrell Pierce prepares a report for the Committee on his recent FOOSL ("Filing Office Operations and Search Logic") joint task force activities. This report will be the primary focus of this meeting.

2. Council Approval.

I have previously submitted a request for $500 for the upcoming calendar year.

3. Membership.

On November 12, 2008, I sent the attached memorandum and enclosures to all Committee members.

4. Accomplishments Toward Committee Objectives.

In the absence of any current or anticipated efforts to revise any Article of the UCC, I believe that this Committee's primary task is to collect and disseminate recent court decisions and learned articles on the UCC. We are accomplishing this task and are keeping abreast of the discussions concerning possible statutory revisions. (See the attachments mentioned in #3 above).

5. Meetings and Programs.

See #1 above.

6. Publications.

See #3 above. The UCC Committee has not been asked recently for any BLJ articles.

7. Legislative/Judicial Administrative Developments.

See #3 above.

8. Miscellaneous.

Nothing to report.

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: November 12, 2008

RE: Materials Recently Distributed by UCC Committee of ABA Business Law Section

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To All:

I am sending to you with this message the following materials distributed recently by the UCC Committee of the ABA Business Law Section.

A. Joint Review Committee for UCC Article 9 Meeting Notes: This document addresses 45 issues identified by this Committee for possible statutory change.

B. Uniform State Laws Scorecard (UCC).

C. Summary of recent decision decided under UCC Article 2A.

D. Summary of recent "good faith" decisions.

E. Spotlight focusing on "some of the most disconcerting judicial decisions interpreting" the UCC.

F. Report of the ABA Business Law Section Letter of Credit Subcommittee (September 2008).

Please feel free to call if you have any questions, etc.

Patrick E. Mears

PEM/ml

Enclosures

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Joint Review Committee for Article 9 of the UCC
Meeting Notes for October 3-5, 2008

Prepared by Professor Stephen L. Sepinuck

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Administrative Matters

The Joint Review Committee will deal with issues identified in the June 2008 report of the Article 9 Review Committee. Other issues will be discussed after the main list is resolved, but the Joint Review Committee needs to seek approval to discuss them from its sponsoring groups to address anything else.

Despite the Joint Review Committee's name, it is a drafting committee. It was not labeled as a drafting committee because this project is not intended to be a major rewrite..

The Committee will not meet again in 2008. Its next meeting will be after the reporter has had a chance to draft changes consistent with the Committee's tentative conclusions. That will probably be in February or March of 2009.

Substantive Issues

The "issue" and "explanation" portions of each of the first 39 numbered items below are reprinted from the June 2008 report of the Article 9 Review Committee. That is followed by a brief note on the deliberations or preliminary decisions of the Joint Review Committee. The remaining numbered items were raised at the meeting but were not included in the June report.

1. Issue: 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.

Explanation: 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.

The Committee agreed that § 9-607(b) allows a SP with an interest in a mortgage note to file an assignment of the mortgage upon default, but it is ambiguous whether the default is by the debtor (the mortgagee) or by the account debtor (the mortgagor). If it is the debtor (the mortgagee) who is in default, what happens if someone buys the mortgage note, so there is no "default" by the assignor? In other words, should the Code effectively give buyers a power of attorney to file an assignment if they didn't bother to get one?

A tentative decision was reached to draft the clarification that § 9-607(a) refers to default by the debtor; § 9-607(b) refers to default by the account debtor. Before a final decision is made, the Committee will seek input from real estate groups.

2. Issue: 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.

Explanation: 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.

There was general agreement that the only way for a SP to buy at a private disposition (outside the situation described in § 9-610(c)(2)) is in accordance with § 9-620. In other words, any attempted private sale to itself is in fact a strict foreclosure and needs to be treated as such. The comment to 9-624 says this. The reporter was given task of drafting something to clarify this, including making a preliminary decision of whether to do this by comment or Code change.

3. Issue: 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. 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.

Should you be able to sell to affiliate, such as new subsidiary formed solely to buy the assets)? It happens frequently when hedge funds shop around and sell to a related entity. Similarly, the finance arms of auto manufacturers often sell back (at 100 cents/dollar) to the manufacturer. The Committee decided not to make any changes in connection with this issue because § 9-615(f) provides an adequate safeguard.

4. 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

The Committee decided to change caption of § 9-625(c)(2) to refer merely to consumer goods and to leave the text of the provision as it is. This will remove the conflict and keep the law as it was under old Article 9.

5. 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.

The Committee agreed that the stray word "acceptance" makes no sense in § 9-627(a), (c), (d) but nevertheless concluded that this does not create a significant problem and thus decided to make no change.

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

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. 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.

There was some discussion about whether Article 11 might remain relevant to an old transactions. The Committee decided to delete it from the official text but include a legislative note to States about whether they should repeal it or retain it for old transactions.

7. 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.

The Committee discussed whether existing lenders can effectively prevent the debtor from re-financing by refusing to issue a payoff letter and whether adding a requirement to issue a payoff letter would be sufficient to solve the problem. The Committee decided to defer any decision on this issue until it receives more information from Bob Zadek about what would be necessary to solve the problem.

8. 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.

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.

The Committee concluded that this was an oversight in the 1998 revisions. It then decided to expand the rule in § 9-317(d) to all types of collateral other than types of collateral covered in subsections (b) and (c).

9. 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.

The Committee reached general agreement that the concept should be the same throughout the Code. It decided to adopt the Article 7 definition of "signed" to the greatest extent possible.

10. 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."

The Committee discussed slightly broader potential problem with the definition of "certificate of title" in § 9-102(a)(10). Specifically, the Article 9 definition seems to require that the COT statute contain a priority rule, but many of them do not. There was a consensus that this problem needs to be addressed. Professors Bill Henning, Linda Rusch, and Stephen Sepinuck agreed to advise the reporter on how to address the problem.

11. 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.

The Committee agreed to adopt the Article 7 definition.

12. 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.

The Committee noted that the DACA task force may have given some people comfort with this issue and that the issue does not seem to be preventing lawyers from giving opinions. The Committee therefore tentatively decided not to address this issue, pending hearing from people who believe there is a real problem.

13. 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.

The Committee agreed that this case creates a whole host of problems – on scope, anti-assignment rules, perfection – and that while a comment would normally be sufficient to respond to a single bad decision, such a comment would not be adequate to change NY law and a large portion of promissory notes choose NY law as governing law. Discussion then followed about how to fix the problem. A tentative decision was reached to have the PEB issue a Commentary in the immediate future to address law outside NY and for the Committee to work with groups in New York, such as the Association of the Bar of the City of New York, to develop a statutory proposal for changing NY statutory law.

14. 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). 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.

The Committee agreed that, under current law, there is no temporary perfection period for collateral acquired after the transaction – whether the debtor moves (*e.g.*, converts) or we have a new debtor. It noted that there can be a similar problem following intra-state moves, but that problem deals only with priority, not perfection.

With regard to solutions, the Committee agreed that providing a temporary perfection period could cause a priority problem: a new secured party interested solely in after-acquired property filing during the grace period against the survivor of the merger could be primed by the earlier filer. The Committee agreed that if there were a temporary perfection period in after-acquired collateral following a move, conversion or merger, nothing should impair the priority of a lender who lends to the survivor during the temporary period before the original SP refiles. However, the Committee did not reach consensus on whether the problem is sufficient to merit a change, with the added complexity it would bring. The reporter will draft a proposal and the Committee will evaluate it.

15. 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 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).

There was extended discussion around the following initial transaction: SP has a security interest in a payment intangible securing an obligation (not a sale). The payment intangible is subject to a transfer restriction. One option is to say that the anti-assignment terms are overridden across the board (upon a disposition by the SP, the buyer would be free of the anti-assignment terms). Option two is that the SP is free to dispose of the receivable, but the buyer is in § 9-408 (and thus subject to restrictions on transfer). Option three is to say that the SP cannot even collect. The Committee was unable to reach consensus on the best approach and will consider this issue again.

16. 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).

The Committee framed the issue as thus: can someone who plans to buy payment intangibles preserve its place in line by filing? There is disagreement about whether filing now has any effect in preserving the filer's place in line. For example, if SP1 files as to payment intangibles, SP2 then buys them and perfects automatically, and then SP1 buys them. Who wins? Is priority governed by 9-322(a), under which SP1 would win, or does § 9-318 allow SP2 to win (because the debtor had no rights to transfer to SP1)?

There was no consensus on what the law should be or whether a change is advisable. The committee members will continue to discuss with broader groups and get input from the market.

17. 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).

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.

The Committee did not want any action on this issue to affect the question of whether a consumer transaction loses PMSI status if the secured obligation includes amounts advanced to cover negative equity, service contracts, gap insurance, or the like. Still, there was some agreement that a secured party should not have to file to perfect a security interest in these ancillary rights if it need not file to perfect a security interest in the goods. In that sense, the issue is similar to the rules that provide that a security interest attaches automatically and is perfected automatically in a supporting obligation. The Committee deferred resolution of this issue until its next meeting.

18. 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.

The Committee agreed that a secured party should not be able to designate the debtor as a transmitting utility on an amendment. It then discussed whether this was a change in the law but decided to take no position on that point. The Committee agreed to expressly provide that transmitting utility status must be indicated on the initial financing statement, and that this will be prospective from the date of the change. Thus no transition rule is needed. If a debtor becomes a transmitting utility after the financing statement is filed, then a new filing will be required if the secured party wants something beyond a five-year life for its filing.

19. 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 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.

The Committee agreed that there are two related issues in this problem: (1) which public record controls (the organic documents, a certificate of good standing, or the searchable database); and (2) must the office be required to maintain the records. As to the first issue, the point was made that electronic records can changed without the consent of the filer (for example, the filing office might choose to "correct" them) and there might be no evidence preserved of when or how the change was made. The issue thus comes down to whether the name used should be the one on the entity's organic documents, a state-generated certificate of organization, a certificate of good standing, or the state's electronic database. The consensus was that the name on the organic documents should be the only correct name, and that this should be a statutory change.

As to the second issue, there was a consensus that the "must maintain" language is problematic and should be changed. There was also consensus that "registered organizations" should include anything that is created by the state or for which filing with the state is required for it to exist. It was not clear whether this phrasing would include business trusts. The Committee charged the reporter with the task of crafting a proposal that removes the ambiguity while also covering the types of statutory and business trusts that meet this standard.

20. 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.

There was agreement that if the debtor is a trust and the trust is a registered organization then the rule of § 9-503(a)(1) should apply, not the rule in paragraph (a)(3), and that a statutory change is needed to clarify that this is the rule. If, on the other hand, the debtor is a trustee, then even if the trustee is a registered organization, paragraph (a)(3) should apply. The reporter will clarify this. No transition rule is needed because this is a clarification of the law.

21. 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.

There was consensus that the rule of § 9-307(e) should and does apply, and that this should be clarified by comment.

22. 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.

There was general agreement that the comment should be elevated to the statute, as in Delaware, if the general policy is not changed. The Committee discussed whether, because of the difficulty of determining the state designated, the place to file against national banks should simply should be a designed jurisdiction, such as the District of Columbia. No decision was reached, in part because of the problems of transition.

23. 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. Tennessee 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).

There was a very extended discussion centered around having a safe harbor rule or mandatory rule, possibly based on the debtor's driver's license. The discussion included the reliability of driver's licenses (what happens if the name on the license changes; what if not all of the characters that can appear on a license cannot be input into the filing office's records), whether any safe harbor should have multiple options or only one, and whether any safe harbor for perfection should also preserve priority. The greatest support was for a single safe harbor based on driver's license issued by the state in which the debtor is deemed to be located under § 9-307, and that the safe harbor should work for both perfection and priority. Nevertheless, no final resolution was reached. The Committee anticipates receiving an extensive report on the subject from the UCC Committee of the State Bar of California.

The Committee discussed the possible transition problems of using a safe harbor based on the debtor's driver's license, but tentatively concluded that they were not likely to be severe (they would arise only if there was an incorrect filing based on the debtor's driver's license that would not be deemed effective under current law and it was followed by a correct filing – a prospect that seemed unlikely).

24. 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 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.

The Committee discussed situations in which someone other than the debtor might wish to file a correction statement. For example, if SP1 improperly terminates SP2's filing, SP1 might wish be able to file a correction statement to reduce its liability (to SP2 or other potential SPs) and SP2 might wish be able to file a correction statement to put others on notice that the termination

statement *might* be inaccurate. However, it was noted that SP2 has an alternative way to give notice: to file a new financing statement.

Moreover, if the facts are different, if SP1 inadvertently terminates its own filing, the termination statement is effective. A later correction statement would have no legal effect (whereas filing a new financing statement would have legal effect) and the Committee does not want to confuse filers in that situation into thinking that the correction statement would be effective.

There was no support for getting rid of § 9-518 because it fulfills its purpose of helping debtors deal with bogus filings. There was some support for expanding the scope of § 9-518 beyond its original purpose and along the lines IACA suggests but the tentative consensus was to not invite further clutter of the filing system with "correction" statements that have no effect. However, the Committee will listen further on this issue, from both filers and filing officers.

25. 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.

Under current law, states are free to create their own form that will be effective, but states must accept the official form. In short, the official form is a safe harbor. The IACA proposal would undermine the uniform effectiveness of the official safe-harbor form.

Several states have already amended their statutes to eliminate the safe harbor because it includes the debtor's social security number, and this seems to be the driving force behind the proposal. The consensus was to preserve a safe harbor form, to change the official form to remove the social security box or black out that box, but not to delegate to IACA the authority to revise the official form.

26. It was suggested that some state filing offices currently apply different rules for paper and electronic filings. For example, there may be no explanation given for why an electronic record is rejected (although an explanation is given for why a written financing statement is rejected) and some filing offices have a system in place to reject electronic filings with certain key words common to bogus filings. The offices also have differing standards on what characters can be input and how many characters can be input for the debtor's name (and other fields). The Committee discussed the ramifications of these differences and whether the Code should include standards for electronic filings. The Committee agreed to review an upcoming report by the Task Force on Filing Office Operations and Search Logic.

27. 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 (9th. Cir. BAP 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.

There was consensus that a purchaser of chattel paper who takes possession of the chattel paper should beat a previous buyer of the payment stream. As to how to achieve that, there seemed

to be consensus that the best way to deal with it was to provide that stripped payment rights from chattel paper remain chattel paper. There was concern about whether this should be expressed generally for all stripped rights or, if phrased only with respect to chattel paper, whether it would create a negative implication regarding other stripped rights (*e.g.*, from a promissory note, general intangible, or security). A tentative decision was to phrase the point narrowly with respect only to chattel paper and to make the point by comment rather than by change to the Code.

28. 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.

The Committee decided not to address this question.

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

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 *In re Enron Corp.*, 379 B.R. 425 (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.

The Committee decided not to address this issue.

30. 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 8-106(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.

The Committee acknowledged that agency law supplements the Code in many places and that this point does not need to be expressed in every place it may be relevant. However, the Committee concluded that the rule in § 8-106(d)(3) goes beyond agency principles, and thus if it were to be made applicable to control in §§ 9-104 and 9-106, statutory change is necessary. The Committee decided that such a statutory change is appropriate and that it should be accompanied by a comment that makes clear that agency principles have always applied and continue to apply.

31. 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.

The Committee concluded that § 9-109 comment 2 is misleading in its statement that no change was intended by the removal of the word "intent." It therefore concluded that a change to that comment was needed.

32. 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, § 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 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.

The Committee concluded that the reference to "the collateral" is to the collateral in the deal, not merely to collateral generally. A new comment will be drafted to this effect. The comment will not address whether the foreign filing system must apply to the particular type of debtor or the particular transaction. The Committee will then decide whether the draft comment would be a net benefit.

33. 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.

A new comment will be drafted to make this clarification.

34. 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 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."

The Committee agreed and a new comment to this effect will be drafted.

35. 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.

A new comment will be drafted to indicate that the filing must be made in each state where the collateral is located.

36. 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.

A new sentence will be inserted in § 9-509 comment 6 that provides that authorization to file need not be in an authenticated record.

37. 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.

The Committee decided that the comment should be clarified to expressly state that subsequent authorization to file makes the filing effective to perfect. The comment should also make it clear that the subsequent authorization makes the filing effective – for priority purposes – from when it was filed. If the comment cannot be drafted in a manner that will be effective, a statutory change will be pursued.

38. 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.

The Committee decided a comment should be drafted to clarify how the notification requirements can be satisfied for internet sales.

39. 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.

The Committee decided that a new comment to Part 7 should be drafted to clarify that § 9-506 applies to in lieu filings.

Committee members and observers raised the following additional issues. The Committee's authority is limited to addressing the issues identified in the June 2008 report of the Article 9 Review Committee. If the Committee wishes to address other issues, it must seek authorization to do so.

40. Should the Code or comments make it clear that a secured party may take an assignment of a filing if there is no underlying security agreement or security interest?

The Committee decided not to seek the authority to address this issue.

41. Whether section 9-318 should be clarified to make it clear that it does not alter the 9-322 priority rules in the following situation:

> SP1 files as to accounts. SP2 files and buys them. SP1 then buys (or takes a security interest) in the same accounts.

Section 9-318 would seem to indicate that SP1 gets no interest at all, but the result should be that SP 1 wins.

The Committee agreed to clarify this (treating it as related to the § 9-318 issues it was already authorized to address)

42. Should the rules of § 9-322(c) be modified to clarify that they relate only to disputes between a secured party with non-temporal perfection and another secured party with temporal perfection?

The Committee agreed to explore at a later time whether this issue is something the Committee should seek authority to address. Professor Ken Kettering agreed to provide material to the Committee on this issue.

43. Should the choice-of-law rule that applies when the collateral is held in trust be changed to the law chosen in the trust agreement? Currently, there is substantial confusion about where to file because it is often difficult to determine whether the trust or the trustee is considered the owner.

The Committee concluded that the problems associated with transitions, non-uniformity (from non-simultaneous enactments) would make this proposed change extremely difficult. In addition, it noted that the law chosen in the trust agreement could change at any time. The Committee therefore chose not to pursue this issue.

44. Do we need to conforming amendments to § 3-302(e) and § 3-303(a)(2), or to their comments, to make it clear that "security interest" in those provisions refer only to security interests

that secure an obligation (not a sale of a promissory note)? For example, with regard to § 3-302(e), the law prior to the Article 9 amendments would not have allowed a buyer of a promissory note who has not yet paid to qualify as a holder in due course. The amendments to Article 9 may have inadvertently changed this.

The Committee agreed to a pursue a change to the comments.

45. Should there be a change to § 9-105 to make clear that you can have a written amendment to electronic chattel paper without affecting control? This is particularly important since the servicer of the chattel paper, which might agree to the amendment, is often not the originator.

The Committee asked Tom Buiteweg for a memo on whether it should address this issue.

UNIFORM STATE LAWS SCORECARD

Survey of Adoptions of Revised Official Text of the UCC[1]

As of September 12, 2008

STATES	Article 1 (2001)	Article 2A[2] (1987) (1990)	Articles 3&4[3] (2002)	Article 6 (1989)	Article 7 (2003)
Alabama	Enacted '04	Enacted '92	Not Enacted	Repeal '96	Enacted '04
Alaska	Not Enacted	Enacted '93	Not Enacted	Repeal '93	Not Enacted
Arizona	Enacted '06	Enacted '92	Not Enacted	Repeal '04	Enacted '06
Arkansas	Enacted '05	Enacted '93	Enacted '05	Repeal '91	Enacted '07
California	Enacted '06	Enacted '91	Not Enacted	Revise '90	Enacted '06
Colorado	Enacted '06	Enacted '91	Not Enacted	Repeal '91	Enacted '06
Connecticut	Enacted '05	Enacted '02	Not Enacted	Repeal '93	Enacted '04
Delaware	Enacted '04	Enacted '92	Not Enacted	Repeal '96	Enacted '04
District of Columbia	Not Enacted	Enacted '92	Not Enacted	Revise '97	Not Enacted
Florida	Enacted '07	Enacted '90	Not Enacted	Repeal '93	Not Enacted
Georgia	Not Enacted	Enacted '93	Not Enacted	Not Enacted	Not Enacted
Hawaii	Enacted '04	Enacted '91	Not Enacted	Repeal '98	Enacted '04
Idaho	Enacted '04	Enacted '93	Not Enacted	Repeal '93	Enacted '04
Illinois	Enacted '08	Enacted '91	Not Enacted	Repeal '91	Enacted '08
Indiana	Enacted '07	Enacted '91	Not Enacted	Repeal '07	Enacted '07
Iowa	Enacted '07	Enacted '94	Not Enacted	Repeal '94	Enacted '07
Kansas	Enacted '07	Enacted '91	Not Enacted	Repeal '92	Enacted '07
Kentucky	Enacted '06	Enacted '90	Enacted '06	Repeal '92	Not Enacted
Louisiana	Enacted '06	Not Enacted	Not Enacted	Repeal '91	Not Enacted
Maine	Not Enacted	Enacted '92	Not Enacted	Repeal '92	Not Enacted
Maryland	Not Enacted	Enacted '94	Not Enacted	Not Enacted	Enacted '04
Massachusetts	Not Enacted	Enacted '96	Not Enacted	Repeal '96	Not Enacted
Michigan	Not Enacted	Enacted '92	Not Enacted	Repeal '98	Not Enacted
Minnesota	Enacted '04	Enacted '91	Enacted '03	Repeal '91	Enacted '04
Mississippi	Not Enacted	Enacted '94	Not Enacted	Repeal '94	Enacted '06
Missouri	Not Enacted	Enacted '92	Not Enacted	Repeal '04	Not Enacted
Montana	Enacted '05	Enacted '91	Not Enacted	Repeal '91	Enacted '05
Nebraska	Enacted '05	Enacted '91	Not Enacted	Repeal '91	Enacted '05
Nevada	Enacted '05	Enacted '91	Enacted '05	Repeal '91	Enacted '05
New Hampshire	Enacted '06	Enacted '93	Not Enacted	Repeal '93	Enacted '06
New Jersey	Not Enacted	Enacted '94	Not Enacted	Repeal '94	Not Enacted
New Mexico	Enacted '05	Enacted '92	Not Enacted	Repeal '92	Enacted '05

STATES	Article 1 (2001)	Article 2A[2] (1987) (1990)	Articles 3&4[3] (2002)	Article 6 (1989)	Article 7 (2003)
New York	Not Enacted	Enacted '94	Not Enacted	Repeal '01	Not Enacted
North Carolina	Enacted '06	Enacted '93	Not Enacted	Repeal '04	Enacted '06
North Dakota	Enacted '07	Enacted '91	Not Enacted	Repeal '93	Enacted '05
Ohio	Not Enacted	Enacted '92	Not Enacted	Repeal '96	Not Enacted
Oklahoma	Enacted '05	Enacted '91	Enacted '08	Repeal '97	Enacted '05
Oregon	Not Enacted	Enacted '89	Not Enacted	Repeal '91	Not Enacted
Pennsylvania	Enacted '08	Enacted '92	Not Enacted	Repeal '92	Enacted '08
Rhode Island	Enacted '07	Enacted '91	Not Enacted	Repeal '01	Enacted '06
South Carolina	Not Enacted	Enacted '01	Enacted '08	Repeal '01	Not Enacted
South Dakota	Enacted '08	Enacted '89	Not Enacted	Repeal '93	Not Enacted
Tennessee	Enacted '08	Enacted '93	Not Enacted	Repeal '98	Enacted '08
Texas	Enacted '03	Enacted '93	Enacted '05	Repeal '93	Enacted '05
Utah	Enacted '07	Enacted '93	Not Enacted	Repeal '96	Enacted '06
Vermont	Enacted '08	Enacted '94	Not Enacted	Repeal '94	Not Enacted
Virginia	Enacted '03	Enacted '91	Not Enacted	Revise '97	Enacted '04
Washington	Not Enacted	Enacted '93	Not Enacted	Repeal '93	Not Enacted
West Virginia	Enacted '06	Enacted '96	Not Enacted	Repeal '92	Enacted '06
Wisconsin	Not Enacted	Enacted '92	Not Enacted	Not Enacted	Not Enacted
Wyoming	Not Enacted	Enacted '91	Not Enacted	Repeal '91	Not Enacted

Please note that the Enactment Date does not necessarily reflect the effective date. Please refer to the applicable statute for the relevant effective date.

Our thanks to the National Conference of Commissioners on Uniform State Laws ("NCCUSL") for their help in compiling the information above. These revisions are based on information provided by NCCUSL as of September 12, 2008.

1. In addition to enactments noted below, all states and the District of Columbia have adopted (i) the 1995 Official Text of Article 5 of the UCC, (ii) the 1994 Official Text of Article 8 of the UCC and (iii) the 1998 Official Text of Article 9 of the UCC.

2. All states have adopted the 1990 version of Article 2A with the exception of Louisiana and South Dakota. Louisiana has not enacted Article 2A and South Dakota still has the 1987 version of Article 2A. A 2003 version of Article 2A has been introduced in Kansas and Oklahoma, but has not yet been enacted in any state.

3. New York is the only state that still has the 1951 version of Articles 3 and 4.

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Subcommittee on Article 2A – Leasing
Teresa Davidson, Chair

LEAF FUNDING, INC. v. CUSTOM HIGHLINE, L.L.C.
Mitigation Evidence Relevant to Liquidated Damages Claim

The court in this case concludes that summary judgment for damages is not appropriate in a breach of contract claim regarding a lease under Article 2A where the lease had a liquidated damages clause but the formula did not include the "usual" offset for proceeds upon disposition.

In *Leaf Funding, Inc. v. Custom Highline, L.L.C., et al.*, Slip Copy, 2008 WL 4305316 (D. Kan. September 18, 2008), Custom Highline, L.L.C. ("Lessee") leased equipment from Leaf Funding, Inc. (as assignee of Five Point Capital, Inc.) ("Leaf") for a period of 60 months with monthly payments. Custom Highline Wholesale, L.L.C. ("Custom Wholesale") and two individuals, Zarif Haque ("Haque") and David Rueschoff ("Rueschoff") guaranteed the lease. Less than a year into the lease Lessee defaulted and Leaf filed a claim against Lessee and the guarantors for $103,990.48 plus interest at 18% per annum, plus reasonable collection costs and attorney fees and possession of the equipment. Of the four defendants, only Rueschoff answered the complaint. The court granted a default judgement against the three non-answering defendants as to liability, but because Rueschoff and the three were admittedly jointly and severally liable, default judgment could not be granted on the amount of damages against the three until the matter was adjudicated against Rueschoff. So, the court turned to Leaf's motion for summary judgment against Rueschoff for breach of contract.

Rueschoff did not dispute that the elements of breach of contract existed -(1) existence of a contract between the parties; (2) sufficient consideration to support the contract (3) plaintiff's performance, (4) defendants' breach of the contract and (5) damages to plaintiff caused by the breach.

Rueschoff, however, asserted that because Leaf did not mitigate its damages, Rueschoff had the right to raise a defense of failure to mitigate and "discover what, if anything, Leaf Funding has done to mitigate its rent damages." Thus, in this motion for summary judgment, the issue for the court became, as a matter of law, is evidence of mitigation relevant to the issue of damages in this lease context?

Leaf argued that just by virtue of the lease in question being a true lease and not a security agreement, there was no requirement under the California Commercial Code to mitigate if the contract did not provide for it. The Court rejected this argument finding no support for it. Similarly, the Court rejected Leaf's argument that since the lease agreement was silent on the issue of mitigation, there was no duty to mitigate. It recognized that Article 2A of the California Commercial Code permitted formula-based liquidated damages upon breach but also noted that the formula used in the subject lease agreement lacked the "usual" offset for net proceeds of disposition, citing Comments to Section 2A-504.

The Court then turned to the doctrine of mitigation under California common law which in part holds,

"[a] plaintiff who suffers damages as a result of either a breach of contract or a tort has a duty to take reasonable steps to mitigate those damages and will not be able to recover for any losses which could have been thus avoided. A plaintiff may not recover for damages avoidable through ordinary care and reasonable exertion...." [citations omitted]

In a commercial context, the doctrine has been used more sparingly, but even in the commercial context, the Court noted, a duty has been imputed on the injured party to minimize its damages. Provided with no clear authority holding that mitigation is irrelevant in the lease context and finding no basis to deviate from the general principals of contract law, the Court found that "the non-breaching party's duty to mitigate is the rule not the exception." "[E]vidence of mitigation, or lack thereof, is relevant to the issue of damages in this case."

Leaf went on to argue that if there was a duty to mitigate, it had sought and been granted replevin and that once repossession occurred, it intended to sell the equipment in a commercially reasonable manner. In response, Rueschoff asserted that Leaf had not demanded return of the equipment nor had Leaf come to the location to retrieve the equipment. With these assertions before it, the Court further found that "there are triable issues of fact as to the duty, extent, and effect of mitigation" precluding summary judgment on the issue of damages. Though summary judgment was granted as to liability, Leaf would have to prove its damages.

The caution to lessors in this case appears to be that though a liquidated damages formula is permitted by Article 2A, it may not stand on its own if such formula fails to take into account mitigation of damages.

Ruthanne Hammett
Vice-Chair
Subcommittee on Article 2A - Leasing

ABA Business Law Section
Uniform Commercial Code Committee
General Scope and Provisions Subcommittee

Kristen David Adams, Chairperson

"What Good Faith Cannot Do"

At the Spring 2008 Business Law Section Annual Meeting in Dallas, the General Scope and Provisions Subcommittee presented a program on the topic of good faith, entitled, "Are We Giving Good Faith a Bad Name?" The program included a brief selected bibliography of cases and articles discussing the topic of good faith. As a follow-up to that program, I thought it might be useful to present some of the cases on good faith that have been decided since the Spring meeting. This time, rather than focusing on the attributes of good faith, as the Spring program and bibliography did, I have focused on what good faith *cannot* do. Some of the propositions presented below are likely to be exceedingly familiar, while others may be less well known. Regardless of whether the cases discussed below present familiar concepts or new ones, it is my hope that it will be useful for readers to have a short list of recently decided cases, gathered in one place, discussing some of the limits on the UCC's concept of good faith.

1. **Bad Faith is Not Its Own Cause of Action.**
The UCC's definition of good faith does not give rise to an independent cause of action under the Code, but instead requires another, supporting cause of action. *Lechoslaw v. Bank of America, N.A.*, ___ F. Supp. 2d ____, 2008 WL 4145778 (D. Mass. 2008). Stated another way, a cause of action for breach of the implied obligation of good faith and fair dealing cannot be used as a substitute for a non-viable claim for breach of contract. *Bellco Drug Corp. v. Global Supply Force, Inc.*, 2008 WL 2901595 (E.D. Pa. 2008); *Novelis Corp. v. Anheuser-Busch, Inc.*, 559 F. Supp. 2d 877 (N.D. Ohio 2008). Along the same lines, failure to act in good faith does not give rise to an independent cause of action in tort. *Adams v. Martinsville Dupont Credit Union*, ___ F. Supp. 2d ____, 2008 WL 4009040 (D.D.C. 2008); *TIG Ins. Co. v. Alfa Laval, Inc.*, 2008 WL 639894 (E.D. Va. 2008).

2. **Article One's Duty of Good Faith Does Not Apply Outside the UCC.**
As recent examples, courts have held that the Article One duty of good faith does not apply to construction services, *Jay Cashman, Inc. v. Portland Pipe Line Corp.*, 559 F. Supp. 2d 85, 2008 WL 2447463 (D.Me. 2008), at-will employment, *Block Corp. v. Nunez*, 2008 WL 1884012 (N.D. Miss. 2008), or employment pursuant to a contract, *Erickson v. Brown*, 747 N.W. 2d 34, 2008 WL 755304 (N.D. 2008).

3. **Good Faith Does Not Rewrite the Express Terms of a Contract.**
Several courts this year have refused to consider extrinsic evidence, presented to vary the express terms of a contract, that was predicated upon Article One's obligation of good faith. *See, e.g., Peach State Roofing, Inc. v. 2224 South Trail Corp.*, ___ So. 2d ___, 2008 WL 2150947 (Fla. App. 2008); *Novelis Corp. v. Anheuser-Busch, Inc.*, 559

F. Supp. 2d 877 (N.D. Ohio 2008); *Pierce v. QVC, Inc.*, 555 F. Supp. 2d 499, 2008 WL 1990449 (E.D. Pa. 2008). The *Novelis* decision includes some particularly good language on this point:

> The implied duty of good faith and fair dealing in commercial contracts that [UCC Article 1] imposes controls the manner in which contracting parties carry out the obligations they have undertaken in a contract; it does not, however, give a court the power to impose additional obligations on one contracting party because a court concludes it is unfair to have the other shoulder a market risk that the former expressly bargained to avoid and the other expressly agreed to assume.

Id. at 85.

4. **Good Faith Does Not Require a Party to Decline to Play its Best Hand.**
This is related to the point made above, but I believe it merits special emphasis. In *Austrian Airlines Oesterreichische Luftverkehrs AG v. UT Finance Corp.*, 567 F. Supp. 2d 579 (S.D.N.Y. 2008), the court allowed a buyer to exercise its contractual right to walk away from the deal after a non-conforming tender, rather than permitting the seller to cure. The court rejected the seller's argument that the buyer was acting in bad faith by taking advantage of the fact that the market price for the goods had fallen significantly. In rejecting this argument, the court found that there was no reason not to give the buyer the benefit of its bargain, especially because both parties were "highly sophisticated and well advised commercial entities."

5. **Good Faith Does Not Require a Certain Duty of Care.**
As the court held in *J. Walter Thompson, U.S.A., Inc., v. First Bank Americano,* 518 F.3d 128, 2008 WL 564967 (2d. Cir. 2008), the UCC's duty of good faith does not impose a standard of care, but instead a standard of fair dealing. Notably, and as discussed in this newsletter's Spotlight column, the court in *In re Jersey Tractor Trailer Training, Inc.*, 2008 WL 2783342 (D.N.J. 2008), errs on this point.

6. **Good Faith Does Not Apply to Parties With No Contractual Relationship**
In *Kahn v. Volkswagen of America*, 2008 WL 590469 (Conn. Super. Ct. 2008), the court refused to allow a purchaser of a Volkswagen automobile to assert a claim against the car's manufacturer based on an alleged breach of Article 1's duty of good faith, because it found that there was no contract between the purchaser and manufacturer to which such a duty could attach.

If you should run across additional cases (or articles) discussing the contours of good faith, including what it can and cannot do, please send them my way at adams@law.stetson.edu. My plan is to continue to update the good faith bibliography that was begun earlier this year, and to make it available to anyone who might be interested.

SPOTLIGHT

October 2008

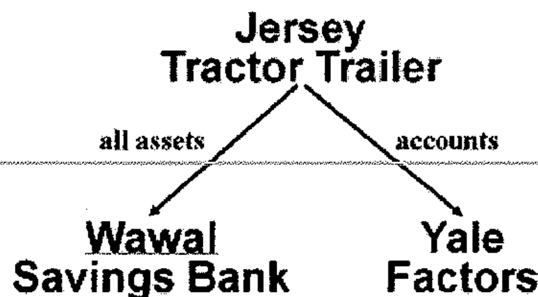
The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the opinion.

In re Jersey Tractor Trailer Training, Inc., 2008 WL 2783342 (D.N.J. 2008)

As reported in the December, 2007 edition of this column, few cases from last year contained as many serious analytical errors as the bankruptcy court's decision in this case. Well, the case is now back. On appeal, the district court repeated all of the bankruptcy court's mistakes, and exacerbated one of them.

The case is essentially a priority battle between two secured parties. It began in 2002, when Wawal Savings Bank granted the debtor, Jersey Tractor Trailer Training, Inc., a $315,000 line of credit secured by an interest in substantially all of the debtor's assets. Wawal perfected its interest by filing a proper financing statement and the security agreement allowed the debtor to collect its own accounts and use the proceeds in its business.

The following year, to alleviate severe cash flow problems, the debtor sought to sell some of its accounts to Yale Factors. In its credit check of the debtor, Yale conducted a UCC search against "Jersey Tractor Trailer Training," an incomplete version of the debtor's name that omitted the corporate identifier. The search failed to disclose Wawal's filing. Relying on its apparent priority, Yale then purchased some of the debtor's accounts and filed its own financing statement.



In late 2005, as the debtor's finances deteriorated, Wawal and Yale each learned of the debtor's relationship with the other. Wawal asserted its priority in the debtor's accounts and the debtor informed Yale that it would not renew its factoring contract. Nevertheless, Yale continued to collect the debtor's accounts and even went so far as to obtain an ex parte restraining order that prohibited the debtor from collecting. The debtor filed for bankruptcy protection and Wawal brought

an adversary proceeding to determine the priority of its interest in the debtor's remaining accounts as well as in amounts that Yale had already collected.

Wawal should win this case. It has the senior security interest. It should win as to the remaining accounts under § 9-322(a)(1) as the first to file or perfect. And, indeed, that is what the court so ruled. Wawal should also win – at least presumptively – as to collections by Yale. That is because of the difference between a disposition of tangible collateral and a collection of receivables. When a junior secured party disposes of collateral, any senior security interest remains unaffected and the buyer takes subject to it. *See* § 9-617. Because of that, the senior secured party has no claim to the proceeds of the junior's disposition. *See* § 9-615(a). However, when a junior secured party collects on accounts, the account debtor's obligation is discharged, with the result that the senior's collateral is gone. To compensate for this, the comments to Article 9 make clear that the junior secured party must account to the senior for the amounts collected, unless the junior qualifies for priority as a holder in due course, good faith purchaser of an instrument, or noncollusive transferee of money. *See* §§ 9-330 comment 7, 9-331 comment 5, 9-607 comment 5.

Unfortunately, the court's analysis is misguided on several key points. First, the court addressed whether Yale took priority in the *accounts* as a holder in due course. This is, of course, an absolute impossibility. A person can be a holder in due course of a *negotiable instrument, see* § 3-302, but there is no such thing as a holder in due course of *accounts*. Nevertheless, the court's whole analysis is premised on the assumption – made without discussion or citation to any supporting authority – that the debtor's invoices to its customers were negotiable instruments. This is absurd. A negotiable instrument is either a promise to pay or an order to pay issued by the person making the promise or order (that is, by the drawer or maker of the instrument), not a writing issued by the person claiming a right to be paid. §§ 3-104(a), 3-105(a). A creditor's invoice thus cannot possibly be a negotiable instrument; it is the wrong kind of document and is issued by the wrong party.

Second, in evaluating whether Yale was a holder in due course, the court focused on the requirement of good faith. This is the most disturbing aspect of the decision. The obligation of good faith requires "honesty in fact and observance of reasonable commercial standards of fair dealing." The latter half of this standard – reasonable commercial standards of fair dealing – is not a requirement that the holder act in a commercially reasonable manner, *cf.* §§ 9-607(c), 9-610(b) (requiring that collections on collateral and dispositions of collateral be conducted in a commercially reasonable manner); it is a requirement of fair dealing. As such, it is a requirement that normally applies only to people in contract with each other. *See* § 1-304 ("every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement"); P.E.B. Commentary No. 10 (February 10, 1994). However, there is language in comment 5 to § 9-331 that indicates otherwise, and expressly suggests that a junior secured party may have a duty to search to determine if a senior lender has contractually prohibited the debtor from granting a junior security interest in accounts.

The bankruptcy court picked up on this comment and took it a step further. It concluded that Yale had failed to act in good faith because Yale had conducted an improper search. Although the

record failed to explain why the search firm had missed the filing, and thus it was unclear whether the error was Yale's or its search firm's, the court ruled that did not matter. It noted that a search revealing no significant secured debt at a time the debtor faced severe liquidity problems "should have raised red flags" and required further inquiry. It described Yale's loan officer as "inexperience[d]" and Yale's conduct as "reckless."

On appeal, the district court agreed with the bankruptcy court. However, it went significantly further. It ruled that "Yale had a duty to search both the debtor's correct corporate name, as well as roots of that name." This is a terrifying prospect and one that is simply inconsistent with one of the major revisions to Article 9. Under old Article 9, a filing was effective if it contained a minor error that was not seriously misleading. Because of this rule, searchers had to search broadly, to ensure they uncovered all previous filings with minor errors. Revised Article 9 modified this rule with respect to the debtor's name. In part because searches are no longer conducted from a paper index (where minor errors may not hinder the searcher from discovering a filing), but instead by computer, revised Article 9 provides that an erroneous filing is ineffective unless a search under the debtor's correct name would reveal it. § 9-506(b), (c). The point of this is to make it easier on the searcher: the searcher need search only under the correct name, not likely variations or misspellings. The district court's decision in this case runs counter that policy. By limiting the circumstances in which a lender can qualify as a holder in due course, it impels prospective lenders to conduct a massive search, something that the revisions to Article 9 attempted to obviate.

There is also a more fundamental problem with the court's analysis. Comment 5 to § 9-331 does indeed suggest that HDC status may require a search of the UCC records. However, there is a big difference between willful blindness – sticking your head in the sand to avoid notice of a conflicting claim – which suggests a lack of fair dealing, and negligence, which does not. Because the good faith requirement of reasonable commercial standards of fair dealing is fundamentally about fairness, not negligence, it should deal with the former, not the latter.

***Phar-Mor, Inc. v. McKesson Corp.*,**
534 F.3d 502 (6th Cir. 2008)

The issue in this case was whether a vendor's reclamation claim was entitled to priority as an administrative expense once the goods subject to reclamation were sold and the proceeds were used to pay a secured creditor. The facts can be summarized as follows. McKesson had sold goods to the debtor prepetition and after the petition filed a timely demand to reclaim the goods under § 546(c) of the Bankruptcy Code. At the debtor's request, the Bankruptcy Court denied reclamation but gave McKesson an administrative expense priority. However, at all relevant times, all of the debtor's assets served as collateral for secured loans. Before the petition, the debtor owed substantial sums to its secured creditors. After the petition, the Bankruptcy Court approved DIP financing under which the DIP lenders acquired a security interest in all of the debtor's assets.

After the secured parties were paid off, the remaining assets were allocated first to the administrative expense claimants, such as McKesson. The debtor objected, claiming that McKesson

actually had no reclamation rights, and therefore was not entitled to administrative expense treatment. The Bankruptcy Court overruled the objection and the debtor appealed.

The Sixth Circuit began its analysis by noting that the question was whether McKesson had a right to reclaim those goods. If so, then the bankruptcy court, having denied reclamation, was obligated to grant McKesson an administrative-expense priority in the amount of the goods (as it did). If not, then the court was not so obliged and McKesson's claim for the value of those goods could be properly regarded as merely a general unsecured claim.

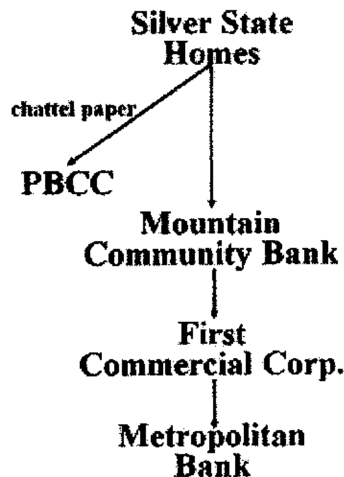
The court then proceeded to analyze McKesson's reclamation rights under § 2-702 of the UCC. It quoted the applicable state's version of § 2-702(3), which provides that "[t]he seller's right to reclaim . . . is subject to the rights of a buyer in ordinary course or other good faith purchaser." The court then properly noted that secured creditors qualify as purchasers. *See* § 1-201(b)(29), (30). Nevertheless, the court concluded that this provision – despite its seemingly clear language – did not restrict McKesson's *right* to reclaim, merely its *ability* to reclaim. It then cited a previous Sixth Circuit decision from 1968 that was troubled by a perceived inequity in allowing the rights of a secured creditor to defeat the rights of a reclaiming seller and which refused to enforce the limitation on reclamation in § 2-702(3). Based on this, the court concluded that McKessen was entitled to priority.

The court may have reached the correct result. After all, it was the debtor who had requested administrative expense priority. Thus, perhaps the matter could have perhaps been resolved on grounds of waiver or res judicata. Alternatively, the court might have concluded that once the secured creditors were fully paid, as they had been, the limitation in § 2-702(3) was no longer relevant. Unfortunately, the court instead simply refused to read § 2-702(3) to do what it clearly purports to do: restrict the seller's reclamation rights. In the process, it has created doubt and confusion as to whether a secured party really does take priority over an unpaid seller.

***Metropolitan Bank & Trust Co. v. Pacific Business Capital Corp.*,** **2008 WL 2277510 (D. Nev. 2008)**

In this case, the court had to resolve a priority dispute between a creditor secured in chattel paper and a purchaser of that chattel paper. The facts can be summarized as follows. The debtor, Silver State Homes, originated chattel paper by selling mobile homes. Its principal lender was PBCC, which had a security interest in the debtor's chattel paper. That security interest was perfected by filing and the security agreement prohibited the debtor from selling the paper without PBCC's consent.

The debtor later sold 160 mobile home notes (chattel paper) to Mountain Community Bank. A representative of PBCC attended the closing and authorized the sale of 32 of the notes free and clear of PBCC's interest. The representative was unaware that the debtor was simultaneously selling an additional 128 notes to Mountain Community Bank. Mountain Community later sold these 128 notes to First Commercial Corp., which in turn resold them to Metropolitan Bank.



The issue came down to whether Metropolitan Bank took free of PBCC's security interest under former § 9-308(a), the predecessor to § 9-330(b). That requires that the purchaser give new value and take possession of the chattel paper in the ordinary course of the purchaser's business and without knowledge that the specific paper is subject to the security interest.[1] The court first commented that the security agreement did not define "ordinary course of business." It then concluded that the sales were not in the ordinary course of the debtor's business because selling the same paper to multiple parties is not in the ordinary course of business.

This analysis of course misses the point entirely. Unlike Article 9's protection for buyers of goods in the ordinary course of business, which inquires whether the sale is in the ordinary course of the *seller's* business, *see* §§ 1-201(b)(9), 9-320(a), the protection for purchasers of chattel paper applies when the transfer is in the ordinary course of the *purchaser's* business. Thus, the court was not focused on the proper inquiry. Beyond that, the provisions of the security agreement – which would be of dubious relevance to the meaning of the statutory phrase "ordinary course of business" even if that phrase did apply to the debtor's business, can have no possible relevance to whether the purchaser – who is a stranger to that agreement – is acting in the ordinary conduct of its own affairs. Frankly, it should not be difficult to ascertain whether a transaction is in the ordinary course of business, *cf.* James J. White & Robert S. Summers, Uniform Commercial Code, Sec. 33-8 (5th. ed., 2002) ("[o]nly rarely will it be difficult to tell whether the seller was 'in the business of selling goods of that kind.'"), and the court in this case seems to be have been trying to solve a problem where none existed.

Nevertheless, the court may have reached the correct result because it noted that there was no evidence that Mountain Community Bank was unaware of PBCC's security interest.

[1] Current law is a bit more lenient. Section 9-330(b) allows the purchaser to take free even if the purchaser is aware that the paper is encumbered as long as the purchaser does not know that the purchase violates the rights of the secured party.

In re Western Iowa Limestone, Inc.,
538 F.3d 858 (8th Cir. 2008)

This case involved the conduct of three fertilizer and chemical dealers who purchased agricultural lime from Western Iowa Limestone, Inc., but left the lime with Western per the terms of the parties' bill of sale, pending the dealers' resale of the lime to their own customers. Western maintained all of its lime, including that which had been sold to the dealers, in a single undifferentiated pile on its premises.

When Western filed for bankruptcy, some lime that had been sold to the dealers remained on its premises. United Bank of Iowa, having a security interest in all of Western's assets, sold the lime as part of Western's inventory. At that time, the dealers filed a joint objection to the planned distribution of the sale proceeds, claiming priority over the bank as buyers in the ordinary course of business as to the purchased, undelivered lime.

Even though the dealers lacked physical possession of the lime, the bankruptcy court held that they had constructive possession, which the bankruptcy court held was sufficient to satisfy the "possession" requirement of § 1-201(b)(9) and give the dealers priority under § 9-320(a). The Bankruptcy Appellate Panel reversed, ruling that the dealers did not have constructive possession. The Panel declined to address whether constructive possession would have sufficed had it been proven. The Eighth Circuit reversed the BAP and affirmed the bankruptcy court on both points, reasoning that, because Iowa courts had construed "possession" to include "constructive possession" in other UCC contexts, there was no reason to do otherwise here.

In so holding, the Eighth Circuit expanded the definition of § 1-201(b)(9) in a way that is not supported by the text of the UCC, the commentary, or the literature in this area. In fact, looking at the Code's treatment of possession elsewhere, there is reason to believe that only actual possession should suffice here. In the 1999 revisions to § 2-716(3), for example, consumers (but not other purchasers) are given a special property in goods upon identification to the contract. As White & Summers note, the new language would allow a consumer buyer to claim that he or she is a buyer in ordinary course of business even without possession. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 33-8 (5th. ed., 2002). The dealers in this case were not consumer purchasers, of course, and it is reasonable to assume that this special provision for consumers would not have been necessary if the word "possession" was automatically intended to include "constructive possession" of the kind that is claimed in this case.

Furthermore, even if constructive possession were acceptable, the facts of this case do not support constructive possession. Instead, constructive possession normally contemplates delivery of the goods to a third party or other exercise of dominion and control on the part of the purchaser. In this case, where the goods remained with the seller in a single, undifferentiated mass, finding constructive possession seems clearly wrong.

Arnold, Matheny & Egan, P.A. v. First American Holdings, Inc.,
982 So. 2d 629 (Fla. 2008)

This case concerns First American Holdings, Inc.'s attempt to collect on a $26,000 judgment against Preclude, Inc. As part of its collection efforts, First American sought to garnish funds that Preclude had received from Greenleaf Products, Inc. in a settlement. Because these funds had been deposited in the trust account of Arnold, Matheny & Egan, P.A. ("AME"), Preclude's attorneys, First American sought to garnish those funds from AME. AME twice denied that it was in possession of any Preclude funds, and this lawsuit ensued. Although the court reached the correct result, its decision contains some misleading and oversimplified statements about negotiability and stop payment.

The sequence of the facts are important. First American served its first writ of garnishment on AME before the settlement funds were received, and AME answered by indicating it did not currently have any funds belonging to Preclude. Two days later, AME received the settlement funds, deposited them into its trust account, and issued two checks drawn on those funds – one check was made payable to AME's operating account in payment of attorney's fees and costs, and the other was made payable to Preclude for the balance of the settlement funds. Four days later, First American served a second writ of garnishment on AME. Again, AME denied it was in possession of any funds that belonged to Preclude. However, AME's check to Preclude was not presented for payment until three days after the second writ of garnishment was served. Thus, at the time of the second writ, the Preclude funds were still in AME's trust account. First American brought suit, seeking to hold AME responsible for the funds eventually used to honor the check to Preclude.

The court held that, as a matter of garnishment law, AME was required to stop payment on the check, because the funds remained in its account at the time of the second writ of garnishment and it had the ability to stop payment had it chosen to do so. This seems correct. In so holding, however, the court made several imprecise statements. First, the court stated that "[i]t is not until presentment that the issuance of a check constitutes full and absolute payment." In truth, presentment is not the crucial moment in time for "full and absolute payment"; instead, *acceptance* and *final payment* are. *See* §§ 3-409, 4-215. Presentment is merely the holder's demand for acceptance and payment; the drawee bank is not committed to make final payment until it accepts the check. *See* § 3-501. This distinction is important because the right of stop payment ends, not at presentment, but when the bank accepts the check or takes certain other action on the check. *See* §§ 4-303, 4-403.

In the final portion of its opinion, the court rejected AME's contentions that attorney trust account funds should be exempt from garnishment and that checks written on attorney trust accounts should be analogized to cashier's checks or certified checks. This too seems correct. However, reaching its conclusion, the court made two statements that are not entirely correct. First, the court cited a 1989 Florida Supreme Court case for the proposition that "neither the bank nor a purchaser of a cashier's check from the bank has a right to 'stop payment' on a cashier's check." While this statement is correct insofar as the remitter is concerned, and is *usually* true insofar as the issuing bank is concerned, it is oversimplified. Instead, there are a few instances in which an issuing bank

may escape liability for refusing to pay a cashier's check or other check it has already accepted. *See* §§ 3-411, 4-403.

The court also attempted to distinguish checks drawn on an attorney trust account from certified and cashier's checks by noting that the latter "are immediately negotiable." This language incorrectly implies that the former are somehow non-negotiable. The distinguishing feature of certified and cashier's checks is that they are "accepted at issuance," not that they are "immediately negotiable." Whether an instrument is "negotiable" depends entirely on whether the instrument satisfies the requirements described in § 3-104. Whether the funds on which the instrument is drawn are subject to garnishment, or whether a bank has already committed to pay the check via acceptance, are entirely separate matters.

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ABA UCC/ComFin Newsletter

Letter of Credit Subcommittee
September 2008

The focus of this article is on recent cases dealing with forum and procedural issues.

1. Forum and Procedural Issues. (a) In *Setzer v. Natixis Real Estate Capital, Inc.*, 537 F.Supp.2d 876 (E.D.Ky. 2008) the applicant sued the issuer and the beneficiary claiming fraud by the beneficiary and seeking to enjoin the issuer from paying on the letter of credit and the beneficiary from drawing on the letter of credit. The beneficiary moved to dismiss on the grounds that the underlying contract had a forum selection clause which required that each party submit to the exclusive jurisdiction of the courts in the State of New York for any legal action or proceeding resulting from the underlying transaction. The court concluded that there was no fraud in the inducement of the underlying contract and that the fraud alleged as grounds for enjoining payment or any draw on the letter of credit did not taint the validity of the underlying contract (or the forum selection clause therein). Accordingly, the court granted the beneficiary's motion to dismiss without prejudice.

The court was silent as to the impact on the issuer. Presumably the issuer was also dismissed from the action. Otherwise the lawsuit would continue in Kentucky as to the applicant's request for a preliminary injunction against the issuer, while the applicant would have had to sue the beneficiary separately in New York. It is also unclear whether the issuer (Fifth Third Bank) was subject to jurisdiction in New York. Clearly the issuer was not a party to the underlying transaction and the forum selection clause.

This case is reminiscent of the facts in three related cases in which three different courts came to different conclusions as to whether the forum selection clause in the underlying contract precluded the court from enjoining the payment under various letters of credit issued to support the obligations in the underlying contract. See *Hendricks v. Bank of America, N.A.*, 408 F.3d 1127 (9th Cir. 2005) (affirming injunction against an issuer despite forum selection clause in underlying contract choosing a different forum); *American Patriot Insurance Agency, Inc. v. Mutual Risk Management, Ltd.*, 364 F.3d 884 (7th Cir. 2004) (affirming dismissal of the injunction action against a second issuer) *aff'g* 248 F.Supp.2d 779, 781 (N.D.Ill. 2003); *Hendricks v. Comerica Bank*, 122 Fed.Appx. 820 (6th Cir. 2004) (vacating injunction issued by trial court). In case of a fraud on the beneficiary, an applicant does not want to be delayed in getting a preliminary injunction based on procedural issues dealing with forum selection clauses. Hence, an applicant needs to consider the impact of a forum selection problem in both the drafting of the underlying contract and in the choice of the issuer.

(b) One can also forum shop as between federal and state court. In that context, the three-party arrangement which constitutes the basic letter of credit scenario also raises issues as to who is a required party in litigation and on what side the issuer is placed.

In *Holiday Isle, LLC v. Clarion Mortgage Capital, Inc.*, 2008 U.S. Dist. LEXIS 30561 (S.D. Ala.2008), the beneficiary under a letter of credit sued Clarion, the alleged issuer, for dishonoring a presentation under the letter of credit. The beneficiary was a citizen of the state of

Alabama, and Clarion was a Colorado corporation. The original complaint was filed in Alabama state court, and Clarion removed the action to federal court on the basis of diversity. Clarion took the position that it was not in fact the issuer of the letter of credit. Based upon this assertion and other facts that came to light after the filing of the initial complaint, the beneficiary sought to amend the complaint to add additional parties who purportedly had misled the beneficiary into believing that the letter of credit was issued by Clarion. One of the additional defendants was an Alabama citizen, and the addition of that potential defendant to the case would destroy diversity jurisdiction. The court granted beneficiary's motion to remand the case to Alabama state court.

In *Graddick, et al. v. BankTrust, et al.*, 2008 U.S. Dist. LEXIS 26826 (S.D. Ala. 2008), the applicant on a letter credit sought a temporary restraining order against the issuer to prevent payment under the letter of credit. Both the applicant and the issuer were citizens of Alabama. The complaint alleged that subject matter jurisdiction in federal court rested on diversity of citizenship on the basis that the "true Defendants are residents of Florida and Tennessee", the "true Defendants" being the escrow agent (the beneficiary), a real estate developer and its principal. Although those persons were not named as defendants in the complaint, they were the only entities from which the applicant sought relief. The court dismissed the complaint on the basis of lack of diversity between the applicant and the issuer.

In *Titan Aviation, LLC v. Key Equipment Finance, Inc.*, 2006 WL 3040923 (N.D. Tex. 2006), Titan, a Texas LLC, the applicant under a letter of credit, sued the issuer and the beneficiary to enjoin payment. The complaint was initially filed in Texas state court, and was removed to federal district court based on the citizenship of the beneficiary, who contended that the issue of Texas citizenship of the issuer could be ignored because the issuer was a nominal defendant who had been improperly joined. The court concluded that the issuer was not a necessary party and that complete relief could be accorded to Titan even if the issuer was not a party to the suit. An injunction preventing the beneficiary from drawing or accepting the proceeds of the LC would provide Titan complete relief. On that basis the court refused to remand the case to state court.

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: November 17, 2008

RE: House Bills Nos. 6231 and 6647

I am enclosing for your review and consideration copies of two related bills presently before the House Committee on Intergovernmental, Urban and Regional Affairs - - House Bills Nos. 6231 and 6647. As you can see from a reading of these bills, they seek to amend MCL §§ 440.9501 and 440.9502 to address the problem of fraudulently filed financing statements.

I would like to obtain from the members of the UCC Committee their opinions concerning these two bills and, to that end, I am scheduling a meeting of the Committee for Monday, December 1, 2008, commencing at 4:00 p.m. here at my office in Grand Rapids. For those persons who would like to participate but cannot attend in person, here is call-in information for your use:

Telephone number: 888-857-3844
Passcode: 742-393-6148

If you cannot participate at all and you have comments on this proposed legislation, please feel free to email me at pmears@btlaw.com.

I will report to the Business Law Council at its December 6, 2008 meeting on the opinions expressed by you. I hope that we are able to reach a consensus on the wisdom (or lack thereof) of these two bills. Thank you for your attention.

Patrick E. Mears

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HOUSE BILL No. 6231

HOUSE BILL No. 6231

June 10, 2008, Introduced by Reps. Lahti, McDowell, Polidori, Lindberg, Brown, Spade, Simpson, Bennett, Corriveau, Valentine and Stahl and referred to the Committee on Intergovernmental, Urban and Regional Affairs.

A bill to amend 1962 PA 174, entitled

"Uniform commercial code,"

by amending section 9501 (MCL 440.9501), as amended by 2004 PA 212.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT:

1 Sec. 9501. (1) Except as otherwise provided in subsection (2),
2 the office in which to file a financing statement to perfect the
3 security interest or agricultural lien is 1 of the following:
4 (a) The office designated for the filing or recording of a
5 record of a mortgage on the related real property, if the
6 collateral is as-extracted collateral or timber to be cut, or the
7 financing statement is filed as a fixture filing and the collateral
8 is goods that are or are to become fixtures.
9 (b) The office of secretary of state in all other cases,

HOUSE BILL No. 6231

1 including a case in which the collateral is goods that are or are
2 to become fixtures and the financing statement is not filed as a
3 fixture filing.
4 (2) The office in which to file a financing statement to
5 perfect a security interest in collateral, including fixtures, of a
6 transmitting utility is the office of the secretary of state. The
7 financing statement also constitutes a fixture filing as to the
8 collateral indicated in the financing statement which is or is to
9 become fixtures.
10 (3) Any financing statement filed under subsection (1)(a) with
11 a register of deeds and any continuation statement, termination
12 statement, amendment, or assignment relating to the financing
13 statement and meeting the formal requisites of this part shall be
14 recorded by the register of deeds, notwithstanding the provisions
15 for witnessing and acknowledging instruments to be recorded in the
16 real property records contained in section 47 of 1846 RS 65, MCL
17 565.47. **THE OFFICE OF THE REGISTER OF DEEDS SHALL SEND NOTICE BY**
18 **FIRST-CLASS MAIL TO THE LAST KNOWN PROPERTY OWNER OF RECORD OF A**
19 **FINANCING STATEMENT FILED UNDER SUBSECTION (1)(A). THE REGISTER OF**
20 **DEEDS SHALL DETERMINE THE FORM OF THE WRITTEN NOTICE. THE NOTICE**
21 **SHALL CONTAIN AT LEAST ALL OF THE FOLLOWING INFORMATION:**
22 **(A) THE DEBTOR'S NAME AND ADDRESS AS SHOWN ON THE FINANCING**
23 **STATEMENT.**
24 **(B) THE SECURED PARTY'S NAME AND ADDRESS AS SHOWN ON THE**
25 **FINANCING STATEMENT.**
26 **(C) A STATEMENT THAT "IT IS AGAINST THE LAW IN THE STATE OF**
27 **MICHIGAN TO FILE A FALSE OR FRAUDULENT UCC STATEMENT THAT AFFECTS**

1 **REAL PROPERTY. IF YOU BELIEVE THIS FILING WAS MADE FALSELY OR**
2 **FRAUDULENTLY, YOU MAY HAVE RECOURSE PURSUANT TO LAW AND SHOULD**
3 **CONSULT AN ATTORNEY."**
4 (4) If the office of secretary of state receives a financing
5 statement under subsection (1)(b) or (2) for filing, and any debtor
6 identified on the financing statement is an individual, the
7 secretary of state shall provide written notice of the filing of
8 the financing statement to that debtor. The secretary of state
9 shall determine the form of the written notice and the written
10 notice shall contain at least all of the following information:
11 (a) The debtor's name and address as shown on the financing
12 statement.
13 (b) The secured party's name and address as shown on the
14 financing statement.
15 (c) The remedies available to the debtor under this act if he
16 or she believes that the financing statement is erroneously or
17 fraudulently filed.
18 (5) In addition to the written notice described in subsection
19 (4), the secretary of state shall provide at no charge to a debtor
20 described in that subsection a copy or image of the filed financing
21 statement and any attachments. If the debtor requests additional
22 copies or searches, the fees provided in section 9525 apply to that
23 request.
24 (6) A person shall not knowingly or intentionally file a false
25 or fraudulent financing statement with the office of the secretary
26 of state under subsection (1)(b) or (2). In addition to any other
27 penalty provided by law, a violation of this subsection is a felony

1 punishable by imprisonment for not more than 5 years or a fine of
2 not more than $2,500.00, or both. If the person is convicted of the
3 violation, the court may find that the financing statement is
4 ineffective and may order the office of the secretary of state to
5 terminate the financing statement and may order restitution.
6 (7) If a person files a false or fraudulent financing
7 statement with the office of the secretary of state under
8 subsection (1)(b) or (2), a debtor named in that financing
9 statement may file an action against the person that filed the
10 financing statement seeking appropriate equitable relief or
11 damages, including, but not limited to, an order declaring the
12 financing statement ineffective and ordering the office of the
13 secretary of state to terminate the financing statement, and
14 reasonable attorney fees.

HOUSE BILL No. 6647

HOUSE BILL No. 6647

November 12, 2008, Introduced by Reps. Lahti, McDowell, Spade, Lindberg, Valentine and Meadows and referred to the Committee on Banking and Financial Services.

A bill to amend 1962 PA 174, entitled

"Uniform commercial code,"

by amending section 9502 (MCL 440.9502), as amended by 2000 PA 348.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT:

1 Sec. 9502. (1) Subject to subsection (2), a financing
2 statement is sufficient only if it does all of the following:
3 (a) Provides the name of the debtor.
4 (b) Provides the name of the secured party or a representative
5 of the secured party.
6 (c) Indicates the collateral covered by the financing
7 statement.
8 (D) PROVIDES THE ORIGINAL SIGNATURE OF THE DEBTOR. IF THE
9 FINANCING STATEMENT IS FILED ELECTRONICALLY, AN ELECTRONIC

HOUSE BILL No. 6647

1 **SIGNATURE IS SUFFICIENT.**

2 (2) Except as otherwise provided in section 9501(2), to be
3 sufficient, a financing statement that covers as-extracted
4 collateral or timber to be cut, or that is filed as a fixture
5 filing and covers goods that are or are to become fixtures, must
6 satisfy subsection (1) and also do all of the following:

7 (a) Indicate that it covers this type of collateral.

8 (b) Indicate that it is to be recorded in the real property
9 records.

10 (c) Provide a description of the real property to which the
11 collateral is related sufficient to give constructive notice of a
12 mortgage under the law of this state if the description were
13 contained in a record of the mortgage of the real property.

14 (d) If the debtor does not have an interest of record in the
15 real property, provide the name **AND ORIGINAL SIGNATURE** of a record
16 owner.

17 (3) A record of a mortgage is effective, from the date of
18 recording, as a financing statement filed as a fixture filing or as
19 a financing statement covering as-extracted collateral or timber to
20 be cut only if all of the following apply:

21 (a) The record indicates the goods or accounts that it covers.

22 (b) The goods are or are to become fixtures related to the
23 real property described in the record or the collateral is related
24 to the real property described in the record and is as-extracted
25 collateral or timber to be cut.

26 (c) The record satisfies the requirements for a financing
27 statement in this section other than an indication that it is to be

1 filed in the real property records.

2 (d) The record is duly recorded.

3 (4) A financing statement may be filed before a security

4 agreement is made or a security interest otherwise attaches.

5 Enacting section 1. This amendatory act does not take effect

6 unless House Bill No. 6231 of the 94th Legislature is enacted into

7 law.