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"WORKOUTS" UNDER REVISED ARTICLE 9: A REVIEW OF CHANGES AND PROPOSAL FOR STUDY

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I.Introduction

A. Background and Purpose

Article 9 of the Uniform Commercial Code [2] governs the creation, perfection, priority and enforcement of consensual security interests in personal property and fixtures, as well as most consignments of personal property and sales of certain types of intangible personal property. Lenders and their advisers rely on Article 9 to provide a specific source of repayment and to protect themselves from the claims of other creditors and bankruptcy trustees as they make, maintain and collect loans secured by personal property. Advisers to troubled companies use Article 9 to serve their clients by conducting due diligence, discovering the interests of various creditor groups and finding opportunities for negotiation with those groups.

With the July 1, 2001 arrival of Revised Article 9 of the UCC, [3] professionals advising creditors and debtors in commercial "workout" situations must understand the new balance of power between their clients. Revised Article 9 reflects a substantial modification and reorganization of its 1972 predecessor, which shifts that balance in a way that is more comprehensive than any change the insolvency community has seen since the Bankruptcy Reform Act of 1978. This article looks beyond the temporary difficulties that creditors will face in the transition to the new law and, instead, examines the fundamental ways that the drafters have recalibrated the parties' rights. These changes are complex and there is a temptation to hope that they are merely incremental improvements. They promise, however, to increase secured creditors' leverage substantially, both before and after the filing of a petition in bankruptcy. As a result, workouts are likely to become much more difficult for debtors, their unsecured creditors and the professionals who counsel them. The game will change dramatically after 2001 and those who understand the changes will benefit from that understanding.

The purpose of this article is to examine the effect that revised Article 9 will have on the pre–bankruptcy negotiations between a troubled commercial debtor and its creditors. Inevitably, these negotiations revolve around rights between the creditors as well as rights between individual creditors and the debtor. These relationships are tested in the shadow of the Bankruptcy Code [4] and are influenced by the scarcity of resources that mark virtually every bankruptcy.

Understandably, creditors of bankrupt debtors often feel like restaurant patrons who not only hate the food, but think the portions are too small. To press the analogy, they also don't like having to wait in line for a table, possibly being seated only to find out the kitchen has just closed. The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nonetheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow. [5]

Both before and after bankruptcy, these negotiations play out on a stage with a large cast. The owner of the business, the secured creditor and unsecured creditor are the three central characters. Revised Article 9 will affect the roles of all of the players in many ways and this analysis will attempt to isolate the most significant of these provisions of the new law and predict some of the most remarkable results.

In seeking that objective, this discussion must bypass several topics. Most significantly, it will not focus on the revised Article 9 transition rules, which for good reason have demanded a great deal of attention, or the issues related to consumer transactions or farm financing under revised Article 9.

Part 7 of revised Article 9 [6] provides a detailed set of rules on the transition from the old to the new law. Those rules are complex and offer secured creditors many opportunities to make mistakes. [7] No doubt, during the five–year transition, some lenders will come to think of new Article 9 as a full–employment program for bankruptcy trustees. The purpose of this article, however, will be to look below the surface of those troubled waters and to identify the long–term changes in the current. In the end, secured creditors may be pleasantly surprised.

Revised Article 9 also contains some interesting and controversial consumer–related provisions [8] and affects farm financing in important ways. [9] Again, these aspects of the new law are largely beyond the scope of this discussion. The consumer changes (or the lack of such changes), however, provide an important backdrop for this analysis. The drafters struggled with the strong, conflicting interests of consumer groups and their creditors, producing results that may be inconsistent or even unintended. [10] Nevertheless, the consumer provisions are the product of a strong debate that recognized (even if it did not resolve) the interests of consumer debtors. In contrast, the rights of secured creditors in non–consumer transactions and the protection of business debtors and their unsecured creditors are carefully crafted to achieve distinct benefits for secured parties. The result of that effort reflects a more consistent desire to make Article 9 a friendlier place for a commercial lender and an environment in which the debtor will have much less room to negotiate.

B. An Abridged History of Revised Article 9

The American Law Institute [11] and the National Conference of Commissioners on Uniform State Laws, [12] as sponsors, review the UCC and recommend revisions when necessary. [13] A Permanent Editorial Board for the UCC [14] "keep[s] abreast of developments that may require changes" in the statute. [15] Based upon the work of a study committee appointed in 1990, the PEB recommended the formation of a drafting committee, which was appointed in 1993 to draft revisions to the statute. [16] Three factors led to the consensus that some provisions of a "fundamentally sound" Article 9 should be revised: (1) the growth of the United States economy (with "unprecedented innovation" in secured credit markets), (2) developments in case law and (3) experience with the Bankruptcy Reform Act of 1978. [17]

The drafting committee worked for five years, and over that period it identified many problems and concerns that had not been addressed by the study group. As a result, the committee chose not to simply amend a few troublesome provisions, as had been done in 1972, but rather to rewrite the entire article, expanding its scope, changing its filing structure to accommodate electronic transactions, and revising its organization and numbering. [18]

The purpose of this analysis is to identify the parts of the revision that may shape workout negotiations in the future. In the portion of the drafting process most pertinent to that analysis, drafters and observers differed sharply over whether there should be a "carve–out" from the scope of the Article 9 security interest, to allow some room for a non–consumer debtor and its unsecured creditors at the workout table.

The carve–out debate focused on a 1996 memorandum from Professor Elizabeth Warren to the Council of the ALI. [19] Professor Warren proposed to limit the ability of a lender under Article 9 to tie up all of the property of a non–consumer debtor. [20] She proposed to accomplish this by permitting a judgment lien creditor to reach as much as twenty percent of the value of a business debtor's assets by a "distribution" that would have been made "on account of such person's inferior judicial lien" after notice to the secured party and providing an opportunity for the secured creditor to force the lien creditor to marshal the debtor's assets and satisfy itself first from unencumbered assets. [21]

The Warren Proposal built on ideas expressed by the principal drafter of the original Article 9, Professor Grant Gilmore. Gilmore's original exclusion of some property from the scope of Article 9 was intended in part to prevent creditors from being able to obtain from their borrowers "all that they may ever own in the indefinite future," and "to penalize a lender who, after allowing his borrower to pile up an intolerable weight of debt, then claims all the assets of the insolvent estate . . . ." [22]

The debates over the consumer provisions and over the need for a carve–out for unsecured creditors of non–consumer debtors highlight the reality that the drafting of uniform laws is at least indirectly subject to political pressures. The drafters need to produce something that can be enacted. [23] Thus, speaking of the consumer proposal, the Chair of the Drafting Committee, William M. Burke, called the result "a 'delicate compromise,' one that is 'not perfect . . . not elegant,' but needed to remove the threat of opposition in the state legislatures, particularly from consumer credit interests." [24]

In part because of that reality, the drafting of revised Article 9 produced strong opinions on both sides. [25] At the end of the drafting process, the advocates of a carve–out found themselves on a path not taken.

While the "Warren Proposal" was presented to the Drafting Committee, it did not have the backing of any group that was in a position to make a credible threat to block the statute at the state level. Tort claimants, who do not yet know who they are, are not well represented in the legislative process. To the extent that they are represented by ATLA [the Association of Trial Lawyers of America], that group appears to have its hands full trying to block tort reform. [26]

At the intersection of the possible routes, however, there was considerable road rage. [27] "This general approach to reducing the barriers to secured credit has been subject to substantial controversy over its economic and social ramifications." [28]

C. Some Revised Article 9 Basics

The new Article 9 as proposed contains a provision stating that it is effective July 1, 2001. [29] The transition rules envision a clean break on that date and the drafters warn us that "[i]f former Article 9 is in effect in some jurisdictions, and this [revised] Article is in effect in others, horrendous complications may arise." [30] This brinkmanship is producing results and revised Article 9 will be the law in a majority of jurisdictions before its July 1, 2001 uniform effective date. With almost six months to go, sources reported adoption of revised Article 9 by 29 jurisdictions and introduction in at least 12 additional jurisdictions. [31]

Revised Article 9 establishes a filing system and related rules that in many ways should make lending easier to administer. [32] It also provides clearer and more detailed rules for various other aspects of secured transactions and resolves many of the issues that haunted practitioners under former Article 9. While former Article 9 applied generally to transactions that were intended to secure the repayment of a debt or performance of an obligation, with only a few exceptions, the revised legislation pulls in a broader range of special types of "security interests," which will help create clarity for specialists. [33] In the process of making these changes, however, the drafters produced a law that, at least on a substantive level, is much more complicated than its predecessor, and will be confusing and dangerous for the generalist. To some extent, the increased complexity of the revised act is apparent from simply counting provisions in the old and new laws. [34] Further, many of the provisions of the revision are quite complex, due in part to the fact that it creates different rules for various types of transactions, which accommodate the parties who regularly engage in those specific transactions, but the result is a much more complex law with new opportunities for confusion.

One example of this improvement at the expense of complexity is found in the expanded availability of "control" as a perfection device. Perfection by control of intangible property is analogous to perfection by possession of tangible collateral. Such perfection, under a "control agreement," was introduced with the 1994 revision of Article 8, [35] and the current revision now applies the device to three new categories of collateral. The steps necessary to achieve control depend, in turn, on the nature of the collateral, and the requisites for control in each setting are defined in a separate section of Part 1 of revised Article 9. [36]

Another example of the complexity of the revision is found in the procedure for perfection of a security interest in goods held by a "bailee." Under former Article 9, it was possible to perfect by possession a security interest in collateral held by a third–party "bailee" simply by giving notice of the security interest to the bailee. [37] Under revised Article 9, for most types of goods, the bailee must execute an "acknowledgment" that it is holding the collateral for the lender, [38] except where (to accommodate mortgage warehousing) the secured party delivers the collateral to a bailee that has previously acknowledged that it will hold the collateral for the secured party. [39]

As this article will explain in more detail, revised Article 9 covers a broader range of transactions than its predecessor. [40] For example, it is now possible to take a security interest in certain interests under insurance policies (health–care–insurance receivables), commercial tort claims and, perhaps most important for this analysis, bank deposit accounts. [41] In addition, the revision pulls in a number of new types of "true sales" of rights to payment of money, expanding the former inclusion of sales of accounts and chattel paper to include sales of promissory notes, license fees, health–care insurance receivables, and a subcategory of general intangibles now called "payment intangibles." [42] Further, new Article 9 also better protects a secured party's interests in the proceeds of its collateral, by expanding the definition of proceeds so as to improve the secured party's automatic security interest in that new collateral. [43] Also, it improves the secured party's options in several other ways after default. [44]

In many of these changes, the revision specifically addresses the concerns of the securitization industry, which has experienced massive growth in recent years. [45] Pulling into Article 9 additional sales transactions that have not been viewed as security interests in the past (sales of promissory notes and payment intangibles) will provide the securitization industry with important statutory support for both the substance and form of its business and will simplify and clarify securitization transactions. In addition, revised Article 9 will improve the ability of the "secured party" (whether as a lender or as a purchaser) to avoid the effect of anti–assignment rules. [46] All of these changes have implications for workouts and bankruptcy that are hard to overstate, leaving fewer unencumbered assets available for the financing of a workout or the payment of unsecured creditors.

The enforceability and attachment (creation) of a security interest will be familiar to practitioners experienced with former Article 9, but the signed security agreement has now been replaced by the requirement of an authenticated record. [47] In addition, the agreement itself is simplified by allowing description of collateral by Article 9 categories (e.g., "accounts").

The security interest is also perfected in ways that are deceptively similar to the procedure under former Article 9. The filing rules, however, are changed significantly. [48] Perhaps the most noticeable effects of the general adoption of revised Article 9 will be the facts that (1) there will be filing in only one place for most transactions, (2) that place will be determined by the location of the debtor rather than the location of the collateral and, (3) for business organizations that are created by registration with a state (e.g., corporations), the location of the debtor will be the state of its registration (e.g., incorporation), instead of the rule under former Article 9, which required the determination of a company's chief executive office. The form of the filing will be simpler, also, requiring no signature and permitting the description of "super–generic" descriptions of collateral (e.g., "all assets" or "all personal property").

The priority rules under revised Article 9 continue to start with the "first–to–file–or–perfect" rule. However, exceptions to the rule for various super–priority interests are more numerous and complicated than they were under former Article 9. The increase in the number of these exceptions stems from the objective, noted above, to cover more types of transactions under the umbrella of Article 9 and to simplify the documentation of those transactions. [49] The complexity also results from the desire to protect third parties while keeping these transactions outside the reach of the trustee under the "strong arm" clause of section 544(a) of the Bankruptcy Code. [50]

Finally, the rules related to default and remedies under revised Article 9 have improved life for commercial lenders in several significant ways. [51] Notably, revised Article 9 rejects the "absolute bar" rule for the calculation of the deficiency following a non–consumer foreclosure. Thus, the commercial lender who fails to comply with the rules contained in Part 6 of revised Article 9 may have its deficiency limited to the amount that would have resulted from a proper sale, but the rules will not completely bar its collection of a deficiency. Similarly, the revision rejects the notion that a "constructive strict foreclosure" can result from a creditor's excessive delay in conducting a foreclosure sale. On the other hand, a purchase of collateral by a secured party or other related purchaser will trigger protections of the debtor, so that the deficiency is to be based on the price that an unrelated party would have paid at a proper sale.

II.The Interplay of Revised Article 9 and the Bankruptcy Code

To begin the analysis of workouts under revised Article 9 and to put the remaining discussion of revised Article 9 provisions in context, it is necessary to review some of central principles of bankruptcy law, particularly at the intersection of the Bankruptcy Code and the UCC. Workouts do occur not in a vacuum, but in the shadow of

bankruptcy. [52] Similarly, Article 9 and the Bankruptcy Code have evolved together, and it is important to remember how some of the provisions of Article 9 dovetail with those of the Bankruptcy Code.

A. Creditor v. Owner

Section 541 of the Bankruptcy Code, which defines the scope of "property of the estate," sweeps into a bankruptcy case a broad range of legal and equitable interests of the debtor, interests of the debtor and the debtor's spouse in community property and interests in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553 or 723. [53] However, the section closes with the following statement, which may seem either inconsistent or redundant, depending on how one reads the preceding text of section 541:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold. [54]

This provision, added at the end of the process of drafting of the Bankruptcy Reform Act of 1978, was an attempt to legislate protection for purchasers of loans in the secondary market. [55] The result has not been perfect, however. "There has been a great deal of disagreement in the cases as to the effect of this provision on participations." [56] One of the concerns of those revising Article 9, therefore, has been to clarify the status of sales of participations.

B. The Strong–Arm Clause

With respect to personal property, section 544(a) (the "strong–arm clause") of the Bankruptcy Code vests the trustee or debtor in possession [57] with the status of a hypothetical and blissfully ignorant judgment lien creditor on the date of bankruptcy.

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists; [or]

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists . . . . [58]

Revised Article 9, like its predecessor, is designed to mesh with this standard completely. It starts with the general rule that, except as otherwise provided by Article 9, a security agreement is effective against all creditors of the debtor. [59] Then, it contains a series of provisions, [60] starting with section 9–317, that constitute exceptions to the general rule of section 9–201(a). One who thus defeats the secured party is a person who becomes a "lien creditor" before the security interest becomes perfected. [61] Finally, to leave nothing to doubt, Article 9 also defines "lien creditor" to include trustees in bankruptcy. [62]

C. After–acquired Property, Future Advances and Proceeds

The floating lien was one of the radical innovations in Article 9. On a policy level, it was a function of Article 9 to allow the debtor to use collateral without the secured creditor's having to take possession of it or to devise something else akin to possession. [63] Except for certain types of collateral, where possession or control by the secured creditor is required, section 9–204 and its predecessor are a broad revision of pre–Article 9 case law, based on the principle that the law "abhorred a secret lien," and the general prejudice against unorthodox chattel security. The old rules were

perceived by the early drafters of the UCC as artificial and they defeated the rights of secured lenders without particularly good purpose, simply forcing lenders to resort to expensive and cumbersome devices meant to prevent exercise of complete dominion and control by the debtor.

The floating lien is given effect under Article 9 by the incorporation of two basic principles. First, the debtor is allowed to have dominion over the property when it arrives. [64] Then, Article 9 explicitly sanctions an after–acquired property clause in the commercial security agreement. [65] The after–acquired property clause is cut off, however, by the filing of a bankruptcy. [66]

As a complement to this broad, after–acquired property provision, Article 9 also validates a security interest in collateral to secure future advances. [67] So, in addition to the fact that secured parties are not limited to collateral existing at the time of the agreement, the secured creditor need not have lent money at the time it files a financing statement, to establish its priority. In bankruptcy, however, court approval is a prerequisite to secured borrowing by the debtor. [68]

Article 9 further facilitates secured transactions by providing that the security interest attaches to identifiable proceeds of the collateral. [69] The scope of proceeds has been expanded in some important ways in revised Article 9, discussed below, but at this juncture it is important to say that Bankruptcy Code section 552(b) empowers the bankruptcy court under certain circumstances to alter a security interest in proceeds "based on the equities of the case." [70] Also, the debtor in possession "may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim." [71]

Proceeds, however, are an important part of the secured creditor's collateral package in bankruptcy. Subject to the "equities of the case" language above, proceeds become "cash collateral" in a bankruptcy and may be used to pay administrative expenses, such as a law firm's retainer for services not yet rendered, only if the interest secured by the collateral is adequately protected. [72] Moreover, at least one line of cases suggests that any proceeds from property, that a debtor has not expended, and that are not necessary to pay expenses of preservation, increase the amount of the secured claim, at least for purposes of re–evaluation of the secured claim at confirmation. [73]

The interplay of these state and federal provisions on proceeds results in some balancing of power between the debtor and its secured creditor in bankruptcy. [74] The secured creditor will often agree early in the case to a court "carve–out" for administrative expenses as a part of a larger negotiation. [75] For example, faced with the possibility of losing a security interest in after–acquired inventory, the secured creditor will commonly negotiate to allow the use of such collateral and the proceeds thereof, in exchange for a replacement lien in post–petition inventory. As a part of all this, the secured creditor may agree to a "carve–out" for administrative expenses.

Before bankruptcy, as we shall see, [76] new Article 9 addresses the secured party's interest in proceeds in an even more favorable way. Significantly, as noted, [77] this is done without a "carve–out" or the other balancing protections of the debtor found in the Bankruptcy Code. This Article will ultimately focus on the effect of these circumstances on loan renegotiation before bankruptcy. [78]

D. Disposition of Property of the Estate

The Bankruptcy Code vests the trustee with broad power to use, sell or lease property of the estate. [79] Chapter 11 of the Bankruptcy Code anticipates that the business of the debtor will continue in the ordinary course. [80]

[In that event,] unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing and may use property of the estate in the ordinary course of business without notice or a hearing. [81]

Outside the ordinary course of business, the trustee may only use, sell or lease property with court authority. [82] As a part of the larger dynamic described above, the debtor may not use cash collateral unless the secured creditor consents or unless the court authorizes such use. [83] The court's authorization to use cash collateral or to sell property outside the ordinary course of business anticipates that the court shall condition the use, sale or lease of encumbered property so

as to provide "adequate protection" of the security interest or other encumbrance. [84]

Closely related to, but to be distinguished from, the sale of assets owned by the debtor under section 363 of the Bankruptcy Code is the assumption and assignment of executory contracts and unexpired leases under section 365. [85] On the face of the Code, the options under section 365 are somewhat limited. The debtor may assume the lease or contract and then may assign it. The first step involves an assumption of the entire transaction. The debtor "cannot...use bankruptcy to effect a modification in its obligations under its leases or executory contracts. Rejection, assumption, or assignment. Not modification." [86]

While there are limits on the assumability and assignability of executory contracts in bankruptcy, [87] many provisions in executory contracts that prohibit or limit assignment of such contracts in bankruptcy are not effective. First, the trustee or debtor in possession can assume an executory contract even though the agreement provides for automatic termination or a right of termination because of bankruptcy or insolvency. [88] In addition, section 365 bars the enforcement of contractual prohibitions or restrictions on assignments of the contract. [89] These can be powerful tools in realizing the value of contract rights or licenses owned by the debtor.

Coupled with these bankruptcy provisions, Article 9 has specific rules on antiassignment clauses. [90] As we shall see, [91] by overriding both contractual and legal limitations on a person's ability to create a broad Article 9 interest in what would otherwise be nonassignable property, new Article 9 both enhances a debtor's powers to assume and assign property in bankruptcy and gives the secured party a grasp on the proceeds that is improved before bankruptcy and even more enhanced after bankruptcy.

III.Changes in the Law of Secured Transactions

A. Scope More Comprehensive

The expanded scope of Article 9 cannot be fully appreciated without understanding the expanded role of securitization transactions in American financial markets. [92] While providing a company with valuable financial advantages, such as off–balance sheet financing at capital market rates, securitization's major advantage from a credit and bankruptcy point of view is the isolation of the asset subject to the transaction from the credit (or the lack of credit) of the business that generated the assets subject to the transaction (the "originator"). [93] A "bankruptcy remote entity" or "special purpose vehicle" is created with the sole purpose of purchasing the assets, such as accounts, from the debtor in an outright sale transaction. The bankruptcy remote entity issues securities backed by the underlying value of the purchased accounts. The proceeds of the securities pass to the originator in consideration of the purchase. The investors in the bankruptcy remote entity are paid from the proceeds of collection of the purchased accounts. By completely separating the accounts from the originating company and providing a sufficient discount, the bankruptcy of the originator might have little or no impact on the financing transaction. [94] And, the special purpose vehicle might have little or no likelihood of filing bankruptcy itself.

Many of Article 9's new rules and definitions were designed to facilitate securitization. The scope of Article 9 has been expanded to cover almost anything that can be conceived as the subject of a securitized transaction. To grasp these ideas, it is necessary to review the scope section (9–109) and the definitions (principally section 9–102). Under former Article 9, sales of "accounts" and "chattel paper" were Article 9 transactions. [95] While this created some difficulty in the case law on its own, as we shall see, it was also too narrow a framework for the expanded securitization industry. This problem is solved in the revision of Article 9 by (1) expanding the definition of accounts and (2) adding the sales of additional cash–producing assets to the scope of Article 9. By pulling into Article 9 everything that the drafters could imagine as the subject of a securitization transaction, the old, non–Article 9 rules are replaced with a set of familiar standards that are designed to facilitate and protect this segment of the financial industry.

1. "Receivables," Including Notes and Payment Intangibles

First, revised Article 9 broadens the definition of "accounts" to include many rights to payment that were formerly "general intangibles." Whereas former Article 9 defined "accounts" to include only payments for goods sold or leased

or services rendered, the new definitions of accounts include such things as payments for electricity, fees and royalties due from the licensing of intellectual property and proprietary information (such as patents, copyrights and trademarks) and fees from software licenses (where the software may be sold separately from the goods.) [96] The expanded definition clarifies the status of payment rights that were either excluded from former Article 9 or subject to some dispute as to their classification.

One of the drafters makes the useful suggestion that we think of these kinds of collateral generally as "receivables." [97] Although they have many characteristics in common, some of these were entirely excluded from coverage by former Article 9, but are now in the category of accounts. Examples are "health–care–insurance receivables" and rights to payment for a policy of insurance issued or to be issued. [98]

Also, under revised Article 9, credit card receivables are classified as "accounts." This clarifies their status, because some courts had treated credit card accounts as either "general intangibles" or "instruments." [99] Further, payments due under installment contracts arising from the sales of real estate will also be "accounts" under revised Article 9. [100] Thus, by definition of "account," in revised Article 9, many "receivables" that would have been "general intangibles" under former Article 9 are now "accounts" under new Article 9.

Finally, the existing definition of "chattel paper" has been expanded to include the forward–looking category of collateral called "electronic chattel paper." [101] While one might suggest that electronic chattel paper is neither chattel nor paper, the drafters' intent to facilitate all types of securitization in the future is apparent.

Another major change in the characterization of collateral by revised Article 9 is the inclusion of additional types of absolute sales of what may be called "receivables," notably various types of loan obligations. [102] Revised Article 9 expands in a number of ways its coverage with regard to assets sold. It now covers a broad range of accounts, payment intangibles (a subset of general intangibles), promissory notes (a subset of instruments) and chattel paper (which has also been expanded). It defines a security interest to cover sales of these assets and section 9–109 explicitly says that Article 9 now covers these transactions. To achieve this change, the two new types of transactions that are subject to Article 9 are sales of "promissory notes" and "payment intangibles." [103] A "promissory note" is the familiar Article 9 "instrument" [104] that need not be negotiable and that "evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds." [105] A "payment intangible" is a subcategory of "general intangible," and is defined as one "under which the account debtor's principal obligation is a monetary obligation." [106]

Thus, Article 9's expansion of accounts and chattel paper is complimented by the addition of sales of promissory notes and payment intangibles, to bring most financial assets that may be the subject of securitizations under the umbrella of the new law. These payment intangibles and the broadened definition of accounts bring all of the rules into Article 9 so that one will know how to either automatically perfect, in the case of payment intangibles, or to file. The intention was that almost everything would fit within the definition of account other than promissory notes, and chattel paper and payment intangibles would be left over. [107] All of these types of collateral involve the right to payment of a monetary obligation.

It is important to an understanding of these changes to say that, while former Article 9 included sales of accounts (factoring) within its scope, economic history since 1972 has produced a massive expansion in loan participations and securitization.

Modern practice has grandly expanded the factor's business. The new practice is called "securitization". In a securitization transaction the creditor sells its accounts to a trustee who in turn sells "shares" or "participations" in the trust to investors. Since former 9–102(1)(b) covered only sales of "accounts or chattel paper", the status of many securitizations was uncertain. [108]

Former Article 9 classified rights to payment that arose from a loan as "general intangibles," if such rights were the subject of an underlying secured transaction, unless they were part of chattel paper. [109] If the rights were to be sold unconditionally, they were not covered by former Article 9 at all, because the only sales included within the scope of former Article 9 were sales of accounts or chattel paper. [110] Accounts arose only from the sale or lease of goods or

services. [111] "The fact that these kinds of receivables were not covered by [former] Article 9 has presented a problem in securitizations which frequently involve sales of loans or credit card receivables." [112]

In addition to the fact that the scope of former Article 9 was not broad enough to cover all the subjects of securitization, the securitization business was traumatized early in the gestation of revised Article 9 by the Tenth Circuit's decision in *Octagon Gas Systems, Inc. v. Rimmer*. [113] *Octagon* suggested that a bankruptcy trustee might succeed to some interest in accounts sold pre–petition, so as to intercept payments on those accounts, reasoning in part that the seller was only a "debtor" under Article 9 and the purchaser was only a "secured party." [114] This suggestion "made the securitization industry apoplectic. The Permanent Editorial Board attempted to lay these issues to rest in PEB Memorandum No. 14." [115]

Accordingly, the various problems confronted by the securitization industry have been addressed in several ways. The broader definition of accounts essentially covers anything but loans. [116] Beyond that, sales of instruments and payment intangibles (i.e., loans) are automatically perfected. [117] Thus, the drafters also took pains to make it clear that a sale is a sale [118] and even that, in the case of sales of promissory notes and payment intangibles, no filing is necessary to perfect. [119] They went further to make it clear that any filing can use any terminology in addition to "debtor" and "secured party." [120] At its base, however, revised Article 9 still is a statute that deals primarily with parties by those names. It remains to be seen whether the courts will heed the instructions of the Permanent Editorial Board since 1993 and the commentary accompanying revised Article 9 and whether the Tenth Circuit will view revised Article 9 as reversing *Octagon*.

The notorious *Octagon* case stands as a warning to all that the statutory use of a single term ["security interest"] to characterize the interests of an owner or lender does have the capacity to confuse. [121]

2. Proceeds

Under revised Article 9, section 9–315 addresses the secured party's interest in proceeds. Like its predecessor (former section 9–306(2)), revised 9–315(a)(1) continues the rule that a security interest in the original collateral is not cut off by a disposition of the collateral, if the secured party does not consent to the sale. The new law also makes it clear that the "consent" that would enable the purchaser to take free of the security interest is not merely consent to a disposition alone, but rather consent to a "disposition free of the security interest." [122]

Revised Article 9 also continues the rule that the secured party has an automatic security interest in proceeds of collateral, even if the security agreement is silent on the question. [123] Attachment is automatic and proceeds need not be explicitly covered by the security agreement. [124] Beyond that, the process of "identifying" proceeds has also been improved, because the courts have attempted to develop tracing techniques to say what is "identifiable." Perhaps the most common tracing rule is the "lowest intermediate balance rule," to determine whether a security interest has attached to proceeds such that they are identifiable although commingled in a deposit account. [125] The drafters have expressly signified their approval of that rule, [126] which analyzes the account on the premise that proceeds are the last monies to be removed from a commingled account.

Finally, if goods become commingled with other goods so as to lose their identity, the entire resulting product or mass becomes "proceeds" and perfection of the security interest in the original collateral will continue in the product or mass. [127] As in its predecessor, [128] revised Article 9 anticipates the possibility that there will be a competing security interest in the product or mass and sets forth priority rules for that event. [129]

Perhaps more significant than those improvements in the rules of attachment, perfection and identification of proceeds is the expansion of the very definition of the proceeds themselves. [130] Former Article 9 required in most cases that the collateral be the subject of a "disposition" before proceeds would be deemed to emerge from the transaction. [131] The revision broadly expands the types of transactions that will generate proceeds and includes the following:

· Leases and licenses. [132] This will blunt, but perhaps not completely erase, cases that have found payments for use of collateral not to be proceeds. [133]

· Insurance proceeds, which now include insurance payable not only from loss or damage to the collateral, [134] but also insurance payments triggered by non–conformity of the collateral, defects and infringement of rights in the collateral, limited, however, to the value of the collateral. [135]

· Distributions "on account of" the collateral, which should extend the secured party's grasp to dividends from investment property collateral and distributions from "supporting obligations." [136]

· Claims related to the collateral, such as Article 2 claims for non–conformity, etc. [137]

To wrap up this already–broad list, revised Article 9 adds to the definition of proceeds "rights arising out of the collateral." [138] By including such new terms as "collections" and "distributions", section 9–102(a)(64) sweeps in rent payments under personal property leases, payments on instruments and payments on investment property. Revised Article 9 closes the definitional circle by defining "collateral" also to include proceeds. [139] Taken together, these provisions make it clear that there will be little in the way of cash that will not be proceeds and will therefore need to be addressed as collateral of the properly documented secured creditor, under the Bankruptcy Code.

Revised Article 9 also accommodates the secondary mortgage market by a complex effort to draw a better line between real estate and personal property. Beyond the distinction between fixtures and real estate, [140] revised Article 9 takes on the difficult task of distinguishing between underlying real estate and a stream of money that comes under a mortgage note, a land sale contract or a lease.

An analysis of the result starts with the basic scope provision of the new law. On the one hand, section 9–109 excludes from revised Article 9 "the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder." [141] However, there are exceptions from the exclusion "to the extent that provision is made for: (A) liens on real property in sections 9–203 and 9–308; (B) fixtures in section 9–334; (C) fixture filings in sections 9–501, 9–502, 9–512, 9–516, and 9–519; and (D) security agreements covering personal and real property in section 9–604." [142] This must be read together with section 9–109(b): "The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply." [143] This issue has been troublesome to some courts confronted with the evolving secondary market for purchases of and participations in mortgages. [144]

These provisions are reinforced by the rules related to attachment [145] and perfection. [146] These are designed to remove the stream–of–money collateral from real estate collateral completely, requiring only compliance with Article 9 in order to attach and perfect.

These rules make an almost clean division between the real estate universe, on the one hand, and the personal property ("stream of payment") universe on the other. With the former, one must perfect by recording in the real estate records; with the latter, one complies with Article 9. The sole exception of this rule has to do with real estate leases and their rents. [147]

3. Deposit Accounts

Deposit accounts were excluded from former Article 9 except to the extent that they contained "proceeds" of other collateral. [148] The exclusion of deposit accounts stemmed from the early drafters' perception that "(s)uch transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law." [149] The reality, however, was that it was very difficult to use deposit accounts as original collateral under non–Article 9 law and a few states enacted non–uniform amendments to make deposit accounts available as original collateral. [150] "When lending in these states ... did not crumple, interest was sparked in including deposit accounts into any revision of Article 9." [151] As in the other areas in which new collateral is pulled into the familiar and clear rules of Article 9 for taking and perfecting security interests, the revision to include deposit accounts should greatly expand the practice of taking bank accounts as collateral, although the effect of this, of course, may be to limit further the number of assets that may be available to cover the cost of a workout.

Now, outside the consumer area, revised Article 9 pulls into its scope security interests in deposit accounts as original collateral. [152] It also takes on the difficult subject of the depositary bank's right of setoff against a commercial deposit account when a secured party claims a security interest in the account. [153] A security interest may even attach to a deposit account without an authenticated security agreement or an adequate description, if the secured party has control of the deposit account. [154] Similarly, there is protection of a security interest in identifiable proceeds of other collateral that end up in the account, so that such a security interest automatically attaches to the proceeds. [155]

Although this article is not about consumer lending, and although revised Article 9 excludes security interests taken in deposit accounts as original collateral in "consumer transactions," [156] it is important to note that the definition of that phrase requires that the obligation be incurred primarily for personal, family or household purposes and that the collateral also be held primarily for personal, family or household purposes. [157] Thus, a loan to an individual for business purposes or a loan to an individual who uses a deposit account for business purposes and secondarily for personal funds may be secured by such an account.

The security agreement creating a security interest in a deposit account may do so specifically or with a general coverage (such as "all deposit accounts") or by allocation or other device that allows the collateral to be determined objectively. [158] A concern for the drafter of the security agreement, however, is that a deposit account is not an "account" or "general intangible," as otherwise defined in Article 9. [159] Thus, "deposit" becomes something of a magic word.

4. Anti−Assignment Override

Another significant enhancement of a secured lender's collateral package is found in a series of provisions that broadly enhance the assignability of rights and property interests. Taken together, these provisions are likely to have the practical effect of adding additional types of collateral of which secured lenders can take advantage. This enhancement of the secured creditor's position will increase its leverage in loan renegotiations by tying up additional assets and, in bankruptcy, can enable the secured creditor to assert a claim to even more proceeds of property of the estate.

Coupled with the bankruptcy provisions for transfer of property of the estate, discussed above, [160] Article 9 has extensive rules on anti−assignment clauses. [161] These override both contractual and legal restrictions upon a debtor's ability to create a security interest in what would otherwise be nonassignable property. As a general matter, these provisions are addressed to security interests in rights to payment. Under section 9−406, both contractual and legal restrictions on creating a security interest in a right to payment (which might include accounts, payment intangibles, etc.) are simply ineffective to prevent the creation of a security interest, to prevent it from attaching or from becoming enforceable, to prevent perfection from occurring, or to prevent enforcement of the security interest. [162] To some extent these are carried over from former Article 9, [163] but revised Article 9 goes beyond its predecessor because it also overrides noncontractual restrictions that arise as a matter of law. Obviously this state law cannot restrict federal law that might limit assignability, but it does override any contrary state law that might, for example, make an account nonassignable. [164]

Revised Article 9 also clarifies that these anti−assignment rules are not limited merely to restrictions that say the assignment is prohibited. [165] They also override restrictions that say the assignment is permitted but only with the consent of the other party to the contract or restrictions that simply declare that assignment will constitute a default. All of those are ineffective to abort the security interest, so that rights to payment of all kinds can be the subject of Article 9 transactions, and the "secured party" who takes a right to payment, whether it takes it to secure a debt or because it has bought the right to payment, does so for the most part without concern for such a restriction in the underlying transaction. [166]

These rights to receive money, of course, are again relevant in securitization transactions. Here, while former Article 9 already rendered contractual any anti−assignment clauses "ineffective," [167] the new Article 9 expands this considerably. [168] It covers the wider range of payment obligations now included as the subject of Article 9 accounts (e.g., fees from franchise rights and intellectual property licenses as well as chattel paper, promissory notes and payment intangibles). [169] New section 9−406, however, goes further, to invalidate not only contractual prohibitions on

assignment but also to take a new step to invalidate restrictions on assignment of payment rights imposed by "rule of law, statute or regulation." [170] The anti−assignment provisions also attempt to close loopholes by reaching mere restrictions upon assignment (short of complete prohibitions) and default, termination or penalty provisions triggered by assignment. [171] To complete the package, section 9−406 expressly applies to assignments as well as to traditional security interests.

Section 9−406, the general rule that overrides these contractual and legal restrictions, does not apply, however, to outright sales of payment intangibles and promissory notes or to security interests (whether they are outright sales or whether they secure a debt) in health−care−insurance receivables. Instead, there are special rules in section 9−408 for these excluded sales. The section 9−408 rules are similar, in that there is an override of contractual and legal restrictions and, to the extent that there might otherwise be an effective restraint on the debtor's alienation of these rights, such restrictions are not effective to prevent the creation, or attachment or perfection of a security interest. This override, however, does not extend to *enforcement* of the security agreement, on the principle that the obligated person should not be required to deal with the assignee. [172] The health−care−insurance receivable may be a useful example of this 9−408(d) exception. The one who is obligated on this receivable is the insurance company. The drafters perceived that there ought to be some protection for someone who is essentially a professional account debtor. So, the insurance company is not required to pay the secured party unless it otherwise agrees. [173] The same is true when a payment intangible or a promissory note is sold. [174] The borrower will not be obligated to perform to an assignee.

This more limited section 9−408, which does not override restrictions on enforcement, applies to more transactions than just payment streams. This protects obligors on general intangibles that are not payment streams. For example, a franchisee's rights under a franchise agreement, generally speaking, are general intangibles and may not be assignable, either by contract or by operation of law. In such a case, section 9−408 also applies. Even though there is an anti−assignment provision in the franchise agreement or even though state law says that the franchisee cannot assign its rights under the franchise, section 9−408 overrides those contractual and legal restrictions to an extent. It permits attachment and perfection but, again, the franchisor is not forced to accept a substitute franchisee. One can have a security interest in the franchisee's rights or, for another example, an intellectual property licensee's rights, but in order to turn that into cash, the secured party will have to wait until the licensee disposes of it, either with the consent of the licensor or, perhaps more significantly, in bankruptcy.

There is another significant limitation on the sale of these assets. Section 9−408 does not entitle the secured party to have access to trade secrets or confidential information. [175] This may give some third parties a veto over a transaction, perhaps because of the kind of industry in which they are involved and because the third party does not want its confidential financial information made available to competitors.

The issue of proceeds of non−assignable property has arisen often in the context of security interests in Federal Communications Commission (FCC) broadcast licenses. In recent years, the FCC has taken the position that a security interest in the license itself cannot be created (because the FCC has a regulatory interest in the identity of the licensee), but a security interest in the proceeds might be different. [176] Although other cases under former Article 9 have gone further to suggest that an anti−assignment provision might prevent the debtor from having "rights in the collateral" under former section 9−203(1)(c), [177] revised Article 9 rejects this approach. Instead, it distinguishes between payment rights and proceeds (which can be reached) and rights that are not money (which cannot).

To understand the importance of this fine distinction in section 9−408, it is important to remember the interplay of Article 9 and the Bankruptcy Code, [178] the effect of which will be to give the secured party a grasp on additional value in the bankruptcy estate. Of course, outside bankruptcy, if the creditor (a franchisor, for example) consents to the sale, the secured party can reach the proceeds. Inside bankruptcy, the creditor's ability to reach the proceeds may allow the creditor to take advantage of the provisions of the Bankruptcy Code that invalidate certain contractual anti−assignment clauses, and may permit the secured creditor to join forces with the debtor in possession or trustee to realize the value from the collateral. Without such cooperation by the secured creditor, the sale by the debtor in possession or trustee would simply produce proceeds that could be claimed by the secured creditor under section 9−408. If this is done in a chapter 11 reorganization context, the value of the secured creditor's interest in the property may be its fair market or "replacement" value rather than its liquidation value, [179] resulting in an enhancement of the

creditor's leverage at confirmation.

A. New Creation and Perfection Rules

1. Creation (Attachment)

Article 9 does not speak in terms of "creation" of a security interest. Instead, section 9–203, like its predecessor, speaks of "attachment" and provides that unless the parties agree to delay attachment, it will occur when the security interest is enforceable. [180] Enforceability continues to turn on the presence of the three elements required by former Article 9: (1) value (consideration); (2) rights in the collateral or the power to transfer rights; (3) and an adequate security agreement. [181] Also continuing a theme of former Article 9, the secured party's possession, [182] its taking delivery of a registered, certificated security [183] or its control of collateral in which a security interest can be perfected by control [184] provides an alternative to a written security agreement, although such transactions as a practical matter will often be accompanied by a writing that clarifies the parties' rights and obligations.

Revised Article 9 addresses the subject of creation of a security interest in language that is designed to facilitate transactions in the electronic age, when the formality of a written signature may be at least burdensome if not unrealistic, and to maintain "medium neutrality," [185] so that references to writings are generally replaced by the term "record" [186] and the word "sign" generally disappears in favor of "authenticate." [187] Finally, the terms "communicate" and "send" also appear in revised Article 9 and anticipate the day that documents may be transmitted in intangible as well as tangible form. [188]

Thus, revised Article 9, with its cyberterminology, no longer speaks of a debtor's signature. [189] Under section 9–203, while preserving the requirement of an agreement as a prerequisite to enforceability and attachment of a security interest in most cases, the new law no longer refers to a signature but requires that the debtor "authenticate" the agreement. [190] Authentication includes the circumstance in which the debtor may "encrypt or similarly process a record" with the present intention to adopt that record and to identify himself or herself. [191] This set of rules may open the door to a broad range of claims by secured creditors. For example, evidence of a record stored in a "digital voice messaging system" may be sufficient. [192] The only limitation expressed by the drafters was that "human memory [alone] does not qualify as a record." [193]

Beyond an authentication, the security agreement must still "create or provide for" a security interest. [194] While the agreement must also provide a "description of the collateral," [195] in non–consumer transactions that do not involve timber, the description may be by classification (e.g., "inventory"), quantity or a computation or allocational formula. [196] Caution should be exercised, however, and the new definitions of UCC collateral should be checked before relying on their generic use in a security agreement. In addition, no super–generic description (e.g., "all assets" or "all personal property") should be used, inasmuch as such descriptions are expressly insufficient. [197] Finally, while revised Article 9 continues to allow an after–acquired property clause in a security agreement [198] and, separately, allows a new category of commercial tort claims as collateral, [199] it is not possible under revised Article 9 to describe commercial tort claims generically (e.g., "all debtor's commercial tort claims"). [200] An after–acquired property clause will not reach such collateral. [201] Thus, even if one's debtor is in the business of being a tort plaintiff, a description should be no more general than "all tort claims arising out of the crash of the debtor's 747 on July 2, 2001." [202]

2. Perfection

In the business of loan administration, monitoring one's filings has become simpler, both as a matter of filing procedure and as a matter of form. The most conspicuous changes in the new Article 9 are in the filing system. No longer will it be necessary for law students and practitioners to parse through three "uniform" variations of a filing pattern that allowed some states to create arcane local filing systems. [203] Rarely should it be necessary to throw up one's hands and file in multiple places in the face of dual–filing ambiguity.

To effect this result, first, filing will be in only one state for most collateral. Perhaps the most noticeable change that will occur under revised Article 9 is the change in the state in which a lender must file if filing is required to perfect a security interest. Under former Article 9, the location of tangible collateral (goods, equipment and inventory)

determined the place of filing, and filings were made in all the states where tangible collateral was located. [204] If the collateral was intangible (accounts and general intangibles), the place for filing was determined by the "location" of the debtor. [205] Under revised Article 9, the "location" of the debtor determines all filing places, even if the collateral is located elsewhere (except for fixture filings, timber, oil and minerals). [206] Accordingly, this change almost always allows a single UCC filing in a single state to perfect security interests in all the debtor's tangible and intangible assets, wherever they may be located.

Next, most local filings will be eliminated. In almost all cases, the only place to file in a state will be the Secretary of State's or other central filing office. Under former Article 9, many states required filing in one or more local county offices for various kinds of debtors or collateral. [207] Under revised Article 9, the only requirement for local filing is for timber, minerals ("as–extracted" collateral, including oil and gas), and fixture filings. [208]

The third major change to simplify the filing system is the new rule that filing for a corporate debtor (or other registered entity) will be in the state where the debtor was organized. [209] Under former Article 9, a debtor was "located" for filing purposes in the jurisdiction where the debtor had its principal place of business or chief executive office or residence. [210] Under new Article 9, all "registered organizations" (such as corporations) and other debtors that are formed by the filing of a charter or similar document (such as LLC's and limited partnerships) will be "located" in the jurisdiction in which the debtor was incorporated or organized.

An unregistered organization (often, a general partnership) is still "located" where it has its place of business. [211] If it has more than one place of business, it is located where its "chief executive office" is found. [212] An individual is located in his or her state of principal residence. [213]

If a debtor is located in a jurisdiction outside the United States and that jurisdiction does not have a filing system that would allow a lender to prevail over a subsequent lien creditor, then the debtor is deemed to be located in the District of Columbia. [214]

Filing under revised Article 9 is much easier on another level. Revised Article 9 actually proposes, in its uniform text, new "safe harbor" forms for UCC filings, a set of standard national forms for financing statements and amendments, and requires the filing officer to accept filings if they are in those forms. [215] There are only two forms – an initial financing statement [216] and a "financing statement amendment," which is to be used for all amendments, assignments, continuations and terminations. [217]

The debtor's signature is not required for financing statements. [218] Revised Article 9 eliminates the requirement that the debtor sign a financing statement. The prescribed forms have no space for a signature. The secured party is automatically authorized to file unsigned financing statements describing the collateral covered in a security agreement that is signed by the debtor. [219] The debtor can also authorize the secured party (by an authenticated record) to file a financing statement that goes beyond the scope of the security agreement. [220] The absence of a signature requirement will make it much easier to develop electronic filing procedures, and the drafters saw no appreciable added risk from the change.

There is no reason why evidence of authority to file, something not normally contested by a debtor who has in fact received credit and who has authenticated a security agreement or has otherwise authorized the filing in an authenticated record, should be on the public record. [221]

Revised Article 9 reinforces the theory that a financing statement is intended merely to put third parties on notice to make further inquiry. The security agreement is the creature by which the security interest is created and which must independently identify the collateral. The corollary to that is that the financing statement can be a simpler document judged by a lower standard.

The basic requirements of a financing statement, set forth in section 9–502(a), are minimal. We have already seen that a set of basic forms is prescribed by the drafters and it is easier to find the correct filing office. A financing statement, when accepted by the correct filing office, becomes effective, [222] so long as it contains the minimal, basic information. [223] While there are a few additional reasons that a filing office is allowed to reject a financing statement, [224] if the

filing office accepts a filing despite the existence of one of the less important reasons for rejection in 9–516(b), the filing is still generally effective. A rejection for any other reason is still effective, unless a "purchaser" is able to attack a filing on the ground that such person gave value to the debtor and reasonably relied on the fact that the financing statement was not of record. [225] Notably, the trustee in bankruptcy loses in that analysis under the "strong–arm clause" of the Bankruptcy Code. [226]

On first reading, this may seem overly complex to the casual practitioner, but the philosophy is that a court should not hold a financing statement that was accepted by a filing office to be ineffective simply because some of the less–critical information is wrong. Get the debtor's name right and identify the secured party (or merely its representative) and the collateral; then, if the filing office accepts the UCC–1, it is effective. The practitioner should be aware of the reasons for possible rejection under section 9–516(b) and observe them carefully as a matter of good practice, because a filing officer's rejection is an event to be avoided. Even if an error in that category occurs, however, acceptance by the filing office acts as an imprimatur that generally renders the bankruptcy trustee's weapons ineffective.

Thus, Section 9–502 sets forth the basic requirements for a financing statement. The initial financing statement is required to contain only minimal information which, in turn, is divided into two categories:

· Requirements for legal effectiveness under section 9–502; and

· Requirements for acceptance by the filing office, under section 9–516(b).

The analysis of this bifurcation becomes increasingly complex, but it was the contemplation of the drafters that only a few things would justify rejection of a UCC–1, even fewer would result in its being declared invalid and fewer still would be vulnerable to the powers of a bankruptcy trustee. Once it has been accepted by the filing officer, to be legally effective (i.e., to avoid a trustee's attack), the financing statement must only provide the debtor's name, the name of the secured party (or a representative) and an indication of the collateral. [227]

In this way, revised Article 9 reduces the information that has been required for completion of a UCC–1, carrying over only the names of the debtor and the secured party and an indication of the collateral covered (unless the collateral is fixtures or timber). The filing officer, however, is required to refuse to accept a financing statement that omits certain additional information, including the type and jurisdiction of organization and mailing address of the debtor. [228] Omission of the latter information (i.e., other than the names of the parties and collateral) will not generally [229] prevent the filing from being effective, if the filing officer ignores that statutory mandate. On the other hand, the filing office is not permitted to reject a filing for any reason other than the reasons specified in revised Article 9 and, if it does so, the tender of the form and the fee still operate as a filing. Thus:

(1) if a financing statement fails to meet the conditions of 9–502, the filing is not effective, even if it is accepted and indexed, (2) if a financing statement satisfied 9–502 but not 9–516(b), and the filing officer refuses to accept it because of its failure, the filing is not effective, (3) if a financing statement satisfies 9–502 but not 9–516(b) and the filing officer accepts it, the filing is effective (for most purposes), and (4) if a financing statement satisfies section 9–502 and the filing officer refuses to accept it for reasons other than those stated in 9–516(b) (we never take financing statements from red haired people), the filing is effective (for most purposes). [230]

Revised Article 9 recognizes that the debtor's name is the most critical piece of information on the financing statement. It is the item of information by which the financing statement will be indexed and by which later searchers will therefore obtain notice. Historically, this item has been the source of a substantial amount of litigation. [231] Revised Article 9, accordingly, has detailed rules for determining whether a debtor's name is sufficiently provided. [232] Financing statements must use the debtor's legal name. If the debtor is a corporation or other registered entity, its name on a financing statement must be its *registered* name, not a tradename, for the financing statement to be sufficient. Lenders should obtain certificates of good standing or the like to confirm both the state of organization and the name of the debtor.

In this one area, revised Article 9 comes close to requiring highly technical accuracy. The general rule (as under former Article 9) is that a financing statement that substantially complies with Part 5 of revised Article 9 is effective even if it contains minor errors that are not seriously misleading. [233] Failure to use the debtor's correct name, however, is a "seriously misleading" error as a matter of law. [234] Nevertheless, even here, there is some protection. An error in the debtor's name is not misleading if a search "using the standard search logic" of the filing office under the correct name would reveal the financing statement in question. [235] These carefully drawn rules should mean that, unless the names on the financing statement are seriously, misleadingly wrong or the collateral is incorrectly described, the trustee in bankruptcy will have a very difficult time challenging a filing under revised Article 9.

The purpose of naming the secured party on the financing statement is to identify the creditor. Again, recognizing the growth of multi–creditor transactions in the economy, revised Article 9 makes it clear that a financing statement can name a representative of a secured party, who may or not be a secured party but who has agreed to act for the secured party(ies). [236] It is not necessary to spell out the capacity of the person named as a secured party. [237]

Revised Article 9 requires of a financing statement that it "indicates the collateral covered." [238] This minimalist language underscores the principle of notice filing and is reinforced by a statutory declaration that the description is sufficient if it even indicates "that the financing statement covers all assets or all personal property." [239] The practitioner should be cautious to remember, however, that such a super–generic description is expressly inadequate for the underlying security agreement. [240]

In summary, the trustee will have a harder time attacking filings under new Article 9 for many reasons. Beyond the "big three" requirements of section 9–502(a), a filing that is accepted by the filing office is vulnerable to attack only if its defect is one of the debtor–related requirements of subsection 9–516(b)(5). [241] Such a rejectable but unrejected UCC–1, lacking required information about the debtor other than the debtor's name, is subject to attack only by a holder of a conflicting perfected security interest or purchaser and only then if, in reasonable reliance upon the incorrect information, the other secured party or purchaser gives value and the purchaser, in the case of chattel paper, documents, goods, instruments or a security certificate, receives delivery of the collateral. [242]

New Article 9 also helps secured parties deal with unauthorized sales of their collateral. Generally, when a debtor disposes of collateral outside of the ordinary course of business, [243] if the disposition is not authorized by the secured party holding a perfected security interest in the collateral, its perfected security interest will continue in the collateral notwithstanding the disposition. [244] The buyer will take free of future advances made after the secured party obtains knowledge of the sale or 45 days after the sale, whichever is earlier, so that the buyer can effectively cut off exposure to future advances by providing notice to the secured party. [245]

Revised Article 9 makes the secured party less vulnerable to sales of its collateral in at least one other respect, adjusting for case law decided under former Article 9. In order for the non–ordinary course buyer to take free of the perfected security interest, the secured party must authorize the disposition *free and clear* of the security interest. [246] Former Article 9 seemed to require only that "the disposition was authorized by the secured party . . ." [247] This led to some confusion over the extent and nature of the consent required of the secured party. [248] This issue is clarified by revised Article 9.

On the other hand, when the disposition is sufficiently authorized, revised Article 9 protects the buyer by making it clear that the buyer "takes free" of the secured party's security interest. [249] Some case law prior to the revision had suggested that the purchaser took the goods subject to a "subordinate" interest that might continue to be held by the secured party. [250]

C. Perfection More Effective

1. Broader Scope

Secured parties will be able to leave less on the bargaining table for the debtor and unsecured creditors under new Article 9's broader scope. Deposit accounts, letter–of–credit rights, health–care–insurance receivables and commercial tort claims are all new to the Article 9 portfolio. It is worthwhile to stop and detail these briefly, as an

introduction to the improvements in the perfection rules under the revision.

Deposit accounts were excluded from the 1972 version of Article 9, except for proceeds contained in a deposit account. Now, deposit accounts can be taken as original collateral in an Article 9 transaction, but the security interest may be perfected only by "control," which generally requires a formal agreement with the depositary bank. [251] Note that if the parties do enter into a control agreement, the secured party's control, and therefore perfection, is not affected by the fact that the debtor may retain the right to use the account. [252]

"Letter–of–credit rights" are rights to payment or performance under a letter of credit. These rights do not include the right to draw under the letter of credit. Under former Article 9, a security interest in the proceeds of a letter of credit could be perfected only by possession of the original letter of credit. [253] Possession will no longer be effective to perfect. Instead, the secured party will need to obtain "control," which will generally require a formal agreement with the issuer. [254]

Former Article 9 excluded all interests in insurance policies of any kind. [255] Revised Article 9 continues that exclusion generally, but covers a limited type of insurance claims, called "health–care–insurance receivables." [256] "Account" now includes the term "health–care–insurance receivable." [257] Health–care–insurance receivable is, in turn, defined as an interest in or a claim under a policy of insurance that is the right to payment of a monetary obligation for health care goods or services provided. [258] Under that definition, however, the range of insurance policies included may be the subject of some debate. [259] Also, despite this expansion of Article 9, federal law will continue to make it difficult to create and perfect enforceable interests in Medicare/Medicaid receivables. [260]

Health–care–insurance receivables will be treated as "accounts" for most purposes, such as for securitization, but here arises one exception to the requirement that security interests in accounts be perfected by filing. An assignment of a health–care–insurance receivable to the provider of the health care services itself will be automatically perfected, [261] so that if, perhaps, the patient goes into bankruptcy as well as into the operating room, the hospital's interest in his or her insurance receivable is automatically perfected.

Like deposit accounts and insurance policies, no tort claims, whether for personal injury or property damage, were included in the scope of former Article 9. [262] Revised Article 9 now covers a new category of collateral called "commercial tort claims." [263] These are non–contractual claims that arise out of a debtor's business or profession, such as commercial property damage, fraud or misrepresentation. [264] Former Article 9 did not permit, or require, the assignment of such claims to be perfected by filing, but now such a collateral assignment or security interest can only be perfected by filing. [265]

To create a security interest in a commercial tort claim, the claim must then exist and be specifically described in the security agreement. [266] It is not necessary that a suit be filed on the claim, but it must be capable of some specific description, so that a collateral description in a security agreement covering "all commercial tort claims" would not be effective, either for existing or future claims. [267]

2. More Comprehensive Perfection

Revised section 9–303(a) provides the baseline definition of perfection. [268] The philosophy and effect of the filing provisions in revised Article 9 express "premises that are implicit and undeveloped in" former Article 9. [269] Thus, revised Article 9 expands the impact of filing in two ways: (1) the expanded scope of new Article 9 brings more collateral into the filing system and (2) revised Article 9 adds types of collateral against which filings are unnecessary. [270]

UCC filings may use terms like "all assets" or "all personal property." [271] Under former Article 9, a financing statement describing the collateral as "all the debtor's assets" would generally be ineffective to perfect a security interest in any collateral. [272] Revised Article 9 allows a UCC–1 (but not the underlying security agreement) to use this kind of description.

Two warnings should be issued in any discussion of the new "all asset" filings. First, a security interest perfected by filing must still be *created* in particular collateral, by an authenticated record, [273] so the existence of an "all–assets" filing may not necessarily mean that the underlying security agreement actually includes all the debtor's assets. Creditors searching the record should not assume that such filings are literally correct. Searchers may need to inquire of secured parties more often. Second, although a UCC–1 may cover "all assets," a security agreement must be somewhat more specific. [274] It is now clear, however, that a security agreement in a commercial transaction can describe the collateral by UCC category (e.g., "accounts"), unless the collateral is a commercial tort claim (which must exist and be described specifically).

Security interests in more types of collateral can now be perfected by filing. Security interests in some kinds of collateral could be perfected under former Article 9 only by possession. [275] When UCC Article 8 (covering stocks, bonds and other types of investment property) was revised in the mid–1990's, filing was added as an alternate means of perfection that would give the lender little protection except in bankruptcy. [276] This practice of "bankruptcy–proofing" has been expanded under revised Article 9. Thus, perfection of a security interest in an "instrument" may now be achieved by filing as well as by possession. [277] It is also possible to "bankruptcy–proof" a security interest in Article 9's new "electronic chattel paper" by filing as well as by control. [278] As with investment property, however, a creditor with such collateral perfected only by filing will generally lose to a creditor perfected by possession or "control." [279] Beyond mere "bankruptcy–proofing," revised Article 9 also allows security interests in commercial tort claims and health care insurance receivables to be perfected by filing. [280]

The art of bankruptcy–proofing secured transactions has evolved over the past half–century and a word of history may be helpful to describe where we have come. The evolution has proceeded on two branches, with the drafters of Article 9 and its predecessors finding new ways to insulate financing transactions from bankruptcy while practitioners have devised increasingly elaborate defenses through "bankruptcy remote" entities and other devices.

On the drafters' side, the process has involved a definition of the powers of the "judgment lien creditor," the most perfect of whom is the bankruptcy trustee. In this regard, the drafters' experience with fixtures is instructive. In the original (1962) version of Article 9, the practitioner was required to make a local filing in order to perfect a security interest in any personal property that might be a fixture. [281] Then, because the art of defining fixtures has always been imperfect, a second filing might have been a practical necessity to protect against the possibility that the fixture would actually turn out to be something else (typically, equipment). [282] A generation of lawyers was introduced to the new, integrated law of secured transactions with the understanding that if one wished to perfect a security interest in fixtures, one needed to do what teachers and practitioners called a "fixture filing." [283]

In 1972, however, the drafting process produced a useful device that made this issue a less threatening. A security interest in fixtures could then be perfected by two methods –– either by a "fixture filing," which was a local filing and gave the most extensive protection, or by a central filing (or wherever else one would file for the goods if they were not fixtures), which gave more limited protection. Thus, section 9–316 of the 1972 Code drew a distinction between a fixture filing and a filing that was not a fixture filing but nevertheless perfected a security interest in a fixture for certain purposes. This change expanded what might be called "degrees" of perfection, so that some perfected security interests are subordinate to other interests. Perfection by filing reduced the number of competing claims of priority in fixtures. Of particular importance was the fact that perfection by a non–fixture filing, as it became available for fixtures, provided limited priority, but especially priority over a trustee in bankruptcy. [284]

Later, as Article 9 was amended in 1994 in conjunction with Article 8, this practice of using the garlic necklace of financing statements to ward off trustees in bankruptcy was further expanded. Whereas stock certificates had long been identified as collateral of which the secured creditor needed to take possession in order to perfect, [285] now it became possible to perfect by filing, at least to a limited extent. A lender could thus make a range of credit decisions about a borrower.

The priority messages are quite clear. If one is concerned only about the trustee in bankruptcy or lien creditor, filing is probably enough. If one has the least doubt about the integrity of his debtor or about the possibility that other secured lenders will spring up, the creditor should have the securities issued in its own name or the entitlement so listed on the books of the broker so as to achieve control and thus priority. [286]

On the transaction side, lawyers were becoming increasingly adept at the development of bankruptcy–remote entities in the "securitization" business. [287] While these attempts were imperfect and sometimes frustrating, they have now become common and in many cases are quite successful.

Revised Article 9 brings these two evolutionary lines together in some ways, providing more opportunities to "bankruptcy proof" a transaction by filing financing statements, while simplifying the process of insulating a transaction through securitization. For the casual practitioner, perfection may have become a much more complex subject, enhancing a secured party's chances for obtaining priority but not necessarily assuring priority over all third parties. As to several kinds of collateral, there are degrees of perfection, [288] but the common denominator in the filing process is the proposition that, if filing is available for a particular type of collateral, filing provides priority over the judgment lien creditor (most commonly meaning the trustee in bankruptcy). [289]

3. Termination and Continuation Rules Improved

New Article 9 makes four additional changes in the filing system, which should give loan administrators more peace of mind after filing:

· Filing office errors do not interfere with the effectiveness of a filing. [290] Revised Article 9 imposes "the risk of filing office error on those who search the files rather than on those who file." [291]

· New Article 9 also provides a longer period before the lapse of perfection under a financing statement in transactions that tend to have longer lives: public–finance transactions (30 years), [292] manufactured home transactions (30 years), [293] transmitting utility transactions (effective until termination) [294] and transactions in which a mortgage serves as a fixture filing (effective "until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property"). [295]

· The continuation rules have been clarified to allow the filing of a continuation statement despite the intervention of a bankruptcy. [296]

· To allow an opportunity to repair errors or mischief in the filing process, filing officers are required to keep a record of a lapsed filing for one year. [297]

4. Purchase–Money Security Interests Clarified

Like its predecessor, new Article 9 accords a degree of super–priority status to purchase–money security interests. [298] It improves and clarifies the status of those interests in several ways.

First, revised Article 9 deals with the issues that troubled some courts under former Article 9's requirement (continued in new Article 9) that the purchase money lender must "enable" the debtor to acquire the collateral. [299] Thus, some courts applied a rule under former Article 9 that purchase money security interests could lose their special status in some circumstances, such as a refinancing of the original debt or having other collateral also secure that debt. [300] New Article 9 rejects that "transformation" rule in non–consumer transactions [301] and, in the process, validates the "dual status" rule that permits collateral to have both purchase–money and nonpurchase–money status. [302]

Revised Article 9 also clarifies that a secured party can obtain a purchase–money security interest in intangible collateral, but only in a narrow circumstance. [303] A purchase–money security interest may be obtained in software if (1) the debtor acquired the software for the principal purpose of using the software in connection with hardware in which the secured party's interest also has purchase–money status and (2) the debtor acquired the software and the hardware "in an integrated transaction." [304]

D. Default and Remedies

Revised Article 9's rules governing default and remedies carry over many of the concepts from its predecessor. Some of the same omissions are still present, for what the drafters found to be good reasons, but some important

improvements have been made.

In the category of changes not made, "default" is still not defined by revised Article 9, but it is a prerequisite to invocation of the rules of Part 6. The characteristics of defaults vary widely between different types of secured transactions and different lender–borrower relationships, so new Article 9 leaves the practitioner with this gainful employment. It is important that the party drafting a security agreement take care to define the event of default that will trigger the secured party's enforcement rights.

Similarly, revised Article 9 makes little change in the basic foreclosure remedies available after default. The secured party may either proceed through applicable judicial process or use a self–help remedy, provided that the latter may be accomplished "without breach of the peace." [305] Revised Article 9 allows the debtor, a "secondary obligor" or another holder of a lien to redeem the collateral before disposition. [306]

Beyond that, a secured creditor may act after default to exercise collection rights against an account debtor or an instrument's obligor and, under Revised Article 9, may also exercise such rights against the parties obligated on new kinds of accounts. [307] In addition to those expanded rights to seek monetary payments from parties to licenses and other new accounts and other categories of collateral, the secured party is also given additional rights to enforce non–monetary obligations. These rights to collect and enforce apply against other parties obligated on the collateral or on a supporting obligation. [308]

One of the rules that the casual observer will find confusing, however, is the fact that the broad enforcement rights granted by section 9–607 are not accompanied by a concomitant duty on the obligor to perform, so that where applicable law excuses, a party (for example, a franchisor) from performing in response to a demand by the secured party, Revised Article 9 does not override that law. [309] At the front end, therefore, the secured party should take this limitation into account in evaluating the debtor's assets. An agreement from the third party on such collateral will enhance that value substantially.

The rules with respect to foreclosure under Part 6 reflect a number of clarifications and improvements, which benefit secured creditors in many ways but also provide new protections for others, especially for parties other than the debtor.

The notice of sale prior to a post–default disposition of collateral is more elaborate than it has been. [310] New Article 9 also requires that the notice describe both the debtor and the secured party, describe the collateral, state the method of intended disposition and advise that the debtor is entitled to an accounting of the unpaid indebtedness and state the charge, if any, for such an accounting. [311] This new complexity, however, is offset by the inclusion of a sample "safe harbor" form for notice. [312] In addition, a notice is sufficient if it either conforms to the safe harbor or otherwise provides the information required by section 9–613(1), even if it contains additional information and even if it contains "minor errors that are not seriously misleading." [313]

Ultimately, in the absence of a waiver of this right following default, both the debtor and any secondary obligors must be given a notice of disposition, [314] and, in a non–consumer transaction, notice must also be sent to other parties with an interest in the collateral. [315] In addition to continuing the rule that notice be sent to any such person from whom the secured party has received a notice of interest, [316] the secured party also has a new duty to search the records and send a notice to anyone who perfected a security interest in the collateral more than ten days before the notice. [317]

On its face, the effect of this will be to impose a new search requirement on the foreclosing secured party and to require that the notice of sale be sent within ten days after that search. There is another protection for the secured party in its compliance with the search process, however, so that if the secured party makes an information request to the filing office within twenty to thirty days before the notice and then either does not receive a response or receives a response that omits a party with a perfected security interest, then the foreclosing secured party's notice will still be sufficient. [318] The moral for other parties with interest in collateral, therefore, is to continue to provide other secured parties "an authenticated notification" of their claims of an interest in the collateral. [319]

Revised Article 9 specifically addresses the amount of notice required in a non–consumer transaction. While section 9–611 requires the secured party to send "a reasonable authenticated notification of disposition," [320] subject to certain exceptions, [321] Section 9–612(b) includes a specific assurance in the non–consumer setting that a ten–day notice is sufficient. [322]

The options for the secured party in disposing of the collateral have been expanded. While many of these changes are clearly designed with the securitization industry in mind, one change, applicable to equipment lenders, enables such secured parties to proceed by rendering the equipment unusable and disposing of it at the debtor's place of business. [323]

The foreclosure process is also improved by adding licensing as a specifically sanctioned method of disposition after default. [324] The breadth of that sanction, however, is tempered by the requirement that "[e]very aspect of a disposition of collateral, including the method, manner, time, place and other terms, must be commercially reasonable." [325] An additional provision, which not only should serve to maximize the return on a foreclosure but also should protect third parties, is a new requirement that the disposition will carry any warranties which would "by operation of law accompany a voluntary disposition of the property of the kind subject to the contract." [326] While such warranties may be disclaimed or modified, [327] again, every term of the disposition must be commercially reasonable. [328]

Another protection for non–foreclosing parties with an interest in the collateral is a new provision that specifically seeks to adjust for sales that may by their nature produce a low price. Thus, there is a new rule for the limited situation in which the transferee is the secured party or a person related to either the secured party or a secondary obligor. "As a consequence, the disposition may comply with the procedural requirements of [revised Article 9] (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price." [329] In those cases, if the sale price is "significantly below" the price that would have resulted from a hypothetical sale to some other third party, then the amount that would have been realized in such a hypothetical sale is the amount to be used in calculating a deficiency due (or surplus owing), even if the sale was otherwise conducted in a commercially reasonable manner. [330]

Revised Article 9 cleans up the foreclosure procedure in one additional way, which may benefit all parties, by allowing for the title to foreclosed collateral to be cleared as a matter of record. [331] By filing a "transfer statement," which recites the facts of default, foreclosure and transfer, [332] a transferee will succeed "of record" to all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certification–of–title system covering the collateral. [333] Note, however, that this transfer statement is not, in and of itself, the act of foreclosure, [334] but is more in the nature of a deed following a real estate foreclosure. The comments suggest that such a procedure under another title–clearing system should be sufficient if it is available and this new device is simply supplemental. [335]

Revised Article 9 makes substantial changes to the rules related to "strict foreclosures," most of which tend to benefit the foreclosing secured party. The existence of equity in the debtor's property is one of the most important and dynamic aspects of any workout negotiation. Therefore, these changes in this part of the foreclosure process, which can cut off equity without a sale, may be as important to the workout negotiation process as any other changes in revised Article 9. By the same token, the importance of this issue elevates it as a potential for abuse, especially in the consumer setting. This may explain the fact that the provisions governing strict foreclosure in both the consumer and non–consumer areas, which are packed into three sections, 9–620 through 9–622, are among the most complex rules in revised Article 9.

Under former Article 9, strict foreclosure was a relatively limited procedure, whereby only a secured party in possession of tangible collateral could propose to keep that property and then only in full satisfaction of the debt. [336] The new law makes several significant changes in this procedure:

· In the non–consumer setting, possession is no longer a prerequisite to strict foreclosure, so that this procedure will be available as a negotiating tool or a remedy in cases involving both intangible property and collateral that has not yet been repossessed. [337]

· The secured party and the debtor can agree to the strict foreclosure. Notice of the proposed action must be given to certain other parties claiming the collateral and any of them may stop the procedure by objecting within twenty days. The debtor can agree to the terms in an authenticated record but only after default [338] and only if the secured party also consents in an authenticated record. [339] As an alternative to the voluntary waiver of the debtor's equity, the secured party can also send the debtor a proposal, setting forth the terms on which it will accept the collateral in satisfaction of the debt. The only condition allowed in the proposal is that the collateral be preserved or maintained and, if the debtor fails to object within twenty days after the notice is sent, the debtor is deemed to have agreed. [340]

· The parties entitled to a copy of the proposal include anyone from whom a secured party received an authenticated notification of an interest in the collateral, before the debtor consented to the procedure, [341] and anyone who held a junior perfected security interest in the same collateral at least ten days before the debtor consented. [342] Note that the fail–safe statutory procedure for determining these junior parties, which is available in a foreclosure by disposition, [343] is not available in the case of strict foreclosure. The strict foreclosure may be stopped by an objection sent by anyone who was entitled to receive notice or by any other non–debtor party with a claim subordinate to the interest of the foreclosing secured party, [344] and received within twenty days after the notifications are sent. [345]

· In one of the most significant additional provisions of revised Article 9's strict foreclosure procedure, the secured party may retain the collateral in partial satisfaction of the debt. This procedure, however, requires that additional conditions be met. The debtor's affirmative consent in an authenticated record after default is required, so that the secured party cannot effect partial satisfaction merely by notice and failure to object. [346] In addition, the proposal for partial satisfaction must also be sent to all "secondary obligors," who have a greater interest in this procedure because it will leave a deficiency for which they may be responsible. [347]

Buried in these complex procedures is another significant change in favor of non–consumer lenders. Revised Article 9 overrules the line of authority that had allowed a debtor to assert that a "constructive" strict foreclosure had occurred, usually in cases involving substantial delay in foreclosure, but under circumstances in which the secured party had not expressly elected to allow its deficiency to be wiped out. [348]

A similar, important change in favor of non–consumer creditors arises when the secured party sues for a deficiency. If the debtor raises the issue of the secured party's compliance with the rules of Part 6, the secured party will have the burden of proof on that issue. [349] The result if the secured party fails is less harsh than it might have been in some jurisdictions in the past. The court is to presume that compliance with Part 6 would have produced proceeds equal to the secured debt and limit the deficiency accordingly. [350] While this rule was perhaps the majority rule under former Article 9, its codification overrules cases that had applied an absolute bar to a deficiency judgment for failure to comply with either the notice requirement or the requirement of commercial reasonableness. [351]

III.Workouts under Revised Article 9

A. Anticipating Problems with New Secured Transactions

Every lender wishes to go into a transaction hoping for the best, although realism may temper optimism (especially in asset–based lending). In any event, a lender's counsel should advise realistically and prepare for the worst. While this article is replete with suggestions for documenting transactions to anticipate trouble under revised Article 9, two devices stand out if for no other reason than because they are so new that counsel may not consider all of their ramifications. These are, whenever practicable, (1) filing a financing statement that covers "all assets" and (2) taking a security interest in deposit accounts. The first, an all–assets filing, should provide a substantial measure of insurance against filing problems as well as an additional alarm for a creditor that wishes to closely monitor a troubled debtor's progress. The second, a properly drafted and perfected security interest in deposit accounts, should give the lender a greater degree of comfort in a workout situation.

1. Consider Filing on "All Assets"

Especially in a situation in which an existing security agreement covers virtually all of the debtor's property, a filing against "all assets" or "all personal property" may be useful to fill in some of the gaps that may exist in the

agreement's litany of new Article 9 categories of collateral. There are other reasons why the lender should consider such a filing. First, especially in the early days of new Article 9, it will help to provide some measure of assurance that security interests in personal property mis–described in an old filing using former Article 9 terminology have been covered by the new filing. In addition, routinely filing on all assets will provide insurance against the inadvertent omission of specific collateral or types of collateral from a previous or new financing statement. Finally, an all–assets filing will establish priority under the first–to–file–or–perfect rule, in the event of a future expansion of the relationship.

Before relying on an all–assets filing for those reasons, however, the lender should be cautious not to believe that simply filing on all assets is a panacea. The security agreement must still include a description of the collateral, at least to the extent of describing it by revised Article 9 classification terminology. [352] That will require careful attention to revised Article 9's new classification scheme, but this may in itself be a useful discipline and enable the lender to pick up more assets that would otherwise become chips on the debtor's side of the table in a workout. It should also be remembered that an all–assets filing, to the extent that it goes beyond the collateral in which the security agreement grants a security interest, must be authorized by the debtor in an authenticated record. [353] Thus, the security agreement should contain a specific authorization of this procedure. This may raise some issues for discussion in negotiating the original transaction. For example, the debtor may wish to have affirmative assurance that the lender will amend its description to enable another secured party to step in and take other assets in the future.

Another practical advantage of this procedure arises when the security agreement includes a covenant not to grant other security interests in any of the debtor's assets without this lender's consent. While such a "negative pledge" is not enforceable against third parties, [354] coupling it with an all–assets filing would provide some practical assurance that the debtor, new secured parties and purchasers of the debtor's non–inventory assets will contact the lender and obtain the consent required by the negative pledge clause.

Finally, in a similar vein, even if the security agreement does not cover substantially all of the debtor's assets and even if there is no negative pledge related to the collateral or other assets of the debtor, the presence of an all–assets filing may serve a useful practical purpose in requiring the debtor to come to the secured party prior to encumbering or disposing of its collateral and in requiring a new lender to inquire into the extent of the actual security interest covered by the filing. In a troubled situation, such an early–warning device might be very useful.

2. Consider Taking Deposit Accounts

Again, the prospect of being able to take a debtor's bank accounts as original collateral is so foreign to most practitioners that its utility may be underestimated. However, not only will it expand a lender's ability to reach cash beyond proceeds but by doing so it will also give the lender a rejuvenated voice in workout negotiations.

As any practitioner experienced in the field of secured transactions and bankruptcy can attest, unencumbered cash is often the starting point for analysis and negotiation in an insolvency situation. The debtor and its advisors need to gain control of the operation of the business and, to accomplish that preliminary goal, they often must find cash for operations. Before the advent of new Article 9, it could be troubling to find cash tied up as proceeds of collateral but it could also be difficult for the lender to maintain its interest in cash. Lock–box arrangements are unlikely to disappear under revised Article 9, but their utility will now be shared with the deposit–account security interest.

B. Improved Creditor's Leverage Before and After Bankruptcy

To some extent, many of the observations that have made to this point relate to the proposition that the secured creditor has more leverage in workout negotiations than it had under former Article 9. It is possible to take security interests in more of the debtor's assets. It is easier to perfect those security interests (at least for protection against judgment lien creditors and trustees in bankruptcy) and it is harder for a troubled debtor to find cash that is not encumbered either by the expanded security interests themselves, the expanded definitions of proceeds or a security interest in deposit accounts.

The secured creditor's ultimate leverage in the workout situation may turn, at least in part, on its ability to anticipate and thwart transfers out of encumbered deposit accounts. If a troubled debtor goes to bankruptcy counsel for advice, an early inquiry is likely to focus on the availability of unencumbered cash from which to pay for the cost of the workout. Bankruptcy provides some prospect of relief, but it will be reassuring to the secured party to have the debtor and its attorney come to the negotiation seeking a pre–bankruptcy carve–out in the same way that the debtor in bankruptcy is now required to obtain secured creditor or court approval for the use of cash. [355]

What if the debtor does not wish to come to the secured creditor with hat in hand, seeking to liberate cash to pay its professionals? Suppose further that the security agreement covers deposit accounts and has an explicit provision (perhaps tied to financial condition) that prohibits the debtor from using its cash to do anything other than pay trade creditors in the ordinary course of business without secured creditor permission. Might the bankruptcy attorney or other turnaround professional be liable for accepting fees if those funds are paid out of a deposit account that is subject to such a prior, perfected security interest? An affirmative answer to that question could give the secured creditor a trump card in a workout negotiation. The answer is not entirely clear but it may emerge from the language of new section 9–332:

TRANSFER OF MONEY; TRANSFER OF FUNDS FROM DEPOSIT ACCOUNT.

(a) [Transferee of money.] A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) [Transferee of funds from deposit account.] A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless *the transferee acts in collusion with the debtor in violating the rights of the secured party.* [356]

The "collusion" standard is intended to deal with the "bad actor" and "is the most protective (i.e., least stringent) of the various standards now found in the UCC." [357]

In order to require disgorgement of funds paid to an attorney or other turnaround professional, that transferee must be found to have colluded with the debtor in violating the rights of the secured party. Is a debtor's workout counsel a "bad actor"? In answering the question, revised Article 9 does not write on a blank slate. Collusion language is already found in Article 8 [358] and, again, that standard of is the "most protective," or "least stringent," of such standards found in the Uniform Commercial Code. [359] The collusion standard of Article 8, in turn, was derived from the Restatement (Second) of Torts section 876, which describes the liability of an individual as an aider or abettor of the tortious conduct of a third party. [360]

The collusion standard requires a secured party, as plaintiff, to show that a transferee was affirmatively engaged in wrongful conduct rather than placing the burden on the transferee to show that the transferee had no awareness of the wrongful conduct. [361] This standard was employed in Article 8 to effect "the long standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully." [362]

The collusion standard of sections 8–503(e) and 8–115 should also be distinguished from the "notice of adverse claim" standard of section 8–105. [363] The collusion standard does not hinge on whether the transferee had notice of an adverse claim, but rather the standard focuses on whether the transferee actually participated in the wrongdoing or significantly assisted or encouraged the wrongdoing. [364] Thus, it seems that a showing of both knowledge of an adverse claim by the transferee and an act in concert by the transferee should be required for a transferee to be found liable under the collusion standard. [365]

Hawkland concludes that the collusion standard is not necessarily a "higher" or "lower" standard than that of the notice of adverse claim standard. [366] Rather, the two approaches simply have two different focuses. The notice of adverse claims standard focuses on the transferee's level or awareness of wrongdoing by the transferor, and the collusion standard focuses on the transferee's "willing participation" in the transferor's wrongdoing. [367] Finally, Hawkland suggests that, in the shadow of the elaborate regulatory system that governs securities intermediaries, it is unlikely that a court will be called upon to interpret and apply the collusion standard under Article 8, and therefore the

standard will for all time remain a matter for "academic speculation." [368] With the enactment of revised Article 9, such litigation may not be far over the horizon. [369]

Thus, the exact components of a case for collusion may become subject to more active speculation. Clearly, there must be some action on the part of the transferee, whether it be active participation or encouragement. The language used in security agreements must create a clear right on the part of the lender to expect such a payment not to be made and that right must be violated, probably with knowledge and intent.

One author makes this suggestion of a remedy:

The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party. [370]

Conversion, however, is also a recognized remedy for a secured party whose collateral is being held by someone not entitled to it. [371]

A. Remaining Factors Encouraging Workouts: Should We Revisit the

"Carve–Out"?

Thus, new Article 9 provides the secured creditor with a broad range of enhancements and protections for its collateral package. Additional collateral is added, that collateral is made more immune to bankruptcy and the administrative process of obtaining these protections is made simpler. Conversely, the plight of unsecured creditors and their representatives (including the trustee and debtor–in–possession) deteriorates in a workout or bankruptcy under revised Article 9.

Did this process go too far? Is it time to revisit the carve–out debate? We have academic analysis on which to base a discussion of these questions, beyond the views of the participants in the drafting process. Until revised Article 9 is tested in an economic downturn, we are unlikely to have completely clear answers, but this article will identify factors that should be the basis for future, empirical study.

Obtaining empirical information about why lenders may be willing to give up some of their rights in negotiation is a recent and, to date, a limited effort on the part of academics. [372] Professor Mann's study of three groups of loans (by finance companies, banks and insurance companies) suggests that negotiation and concession by lenders is the norm. [373] Mann's observations tend to confirm what practitioners might suspect, which is that a major motivation in workout negotiation by lenders is a "fear of repossession," as they seek to allow time to sell businesses in an orderly fashion [374] and to avoid the out–of–pocket costs of forced liquidation. [375]

Mann's results may have been skewed by the economic conditions prevailing at the time of his study. Studying loan defaults in the 1990's may be akin to studying the effects of hunger in an upscale restaurant. Mann reported that debtors in his sample were able to refinance defaulted loans "with a frequency that I found astonishing." [376] We cannot say today whether the result will be different in an economy following a downturn, although the conditions for such a study may soon be available. [377]

In the abstract, there may be many benefits of renegotiation. While the creditor may foreclose and the debtor may redeem, "in many situations it may be better for the borrower and lender to enter into a renegotiated credit arrangement. If this appears to be the case, the parties presumably would prefer to engage in good faith negotiations to secure a workout agreement." [378]

Professor Tracht identifies a number of barriers to effective renegotiation in the workout setting. At the outset, renegotiation of contracts (which are inevitably drafted without perfect foresight) is a costly process. [379] In addition, the parties are often locked in a bilateral monopoly, particularly in a "tight credit" environment, so that they have little choice but to negotiate with each other and each party is motivated to obtain advantages at the other's expense. [380]

This is exacerbated by the tendency of each party to withhold information to prevent the other from opening the negotiations at the highest level possible. [381] Given the subjectivity inherent in the valuation of commercial collateral, such bargaining tactics may be inevitable but inefficient. [382]

An objective carve–out would be one way to ensure that the debtor and its unsecured creditors will have a place at the workout table. Even without it, though, there are other factors that militate in favor of accommodation by a secured party in the workout process and until workouts become more difficult in the face of economic downturn, we cannot say how the revision of Article 9 will play into that decision by lenders.

Among the other factors in a workout negotiation that might make a carve–out unnecessary, Professor Tracht focuses on the equity of redemption and suggests that it fosters renegotiations several ways. [383] Appropriately, therefore, the process of revising Article 9 included considerable discussion of whether the debtor might waive its right of redemption. [384] New Article 9 clarifies the redemption rights of various parties interested in a secured transaction, with the result that debtors, secondary obligors, other secured parties and lienholders may redeem collateral, but only until the collateral is collected or the foreclosure process is complete, [385] and only by the tender of payment of the entire obligation secured, including reasonable expenses and attorneys fees. [386] In a non–consumer transaction, this right may be waived by a debtor or secondary obligor, but only after default and only by an authenticated record. [387]

Ultimately, then, revised Article 9's section 9–624(c) allows waiver of redemption by the debtor or a secondary obligor, [388] except in a "consumer–goods transaction," and only in an "authenticated" agreement entered into after default. [389] Under some circumstances, allowing waiver by commercial borrowers after default may facilitate efficient negotiation.

Simply prohibiting waivers [of the equity of redemption] as a part of the workout process, however, would probably be inefficient: the borrower's ability to waive default rights as a part of a workout may provide an important signal to the lender that the borrower has faith in its own workout proposal. [390]

At least two words of realism are appropriate. First, all of these protections for the debtor/originator are, by definition, to be avoided by the securitization transaction. The nature of securitization is to sell, not to finance. Even if the underlying transaction is a financing transaction, the nature of the securitization exercise is to remove that transaction from the books of the originator. If the "sale is a sale" language is read by the courts as the drafters hope, it seems unlikely that the originator will have any basis for expecting the bankruptcy remote entity or its investors to engage in workout discussions. The workout, if any, will occur between the special purpose vehicle and the underlying borrowers, if it is a securitization vehicle that contains financial assets. In other words, the bankruptcy remote entity may have to negotiate over the payment of the underlying obligations, but even then, the relationship between the investors and the underlying borrowers will be tentative at best.

As a practical matter, and especially in a troubled economy, redemption rights are exercised infrequently and Tracht suggests that the power to waive these rights may become irresistible. [391] A defaulting debtor almost by definition does not have the financial ability to avoid default and, with collateral of questionable value in an economic environment that includes a shortage of eager lenders, is unlikely to be able to pay the entire secured obligation. A redemption by some other party such as a junior lender will often simply substitute the identity of one lender for another in the negotiation process, although this may enhance the prospects for workout slightly, particularly if the original secured party was eager to seize the equity value in the property, and redemption by such a junior lender might slow down the foreclosure process and allow more time for negotiation.

Aside from these statutory devices, the first factor that may dissuade a secured party from moving rapidly toward liquidation is the fear of the cost of that process. Such costs are both subjective and objective. Subjectively, the creditor must consider the likelihood that rapid liquidation deprives it of the opportunity to sell the collateral as part of an ongoing business. Fewer buyers may be available in the short term. Objectively, of course, rapid liquidation may also require the secured party immediately to incur out–of–pocket costs for legal fees, security, insurance, and the costs of preserving the collateral. It may serve the secured party's interests to work with the debtor and to facilitate the payment of professionals –– an attorney, an accountant or a turnaround manager to preserve the operations of the debtor while casting a wider net for prospective buyers. This is especially true in a business that is seasonal or has

management problems that the debtor is willing to address.

As the economy moves away from the positive conditions in which revised Article 9 was drafted, however, secured parties may opt less often for an orderly reorganization or liquidation of debtors' businesses. Again, this may especially be true in the context of securitized transactions, in which the investors in the special purpose vehicle have even more reason under new Article 9 to hope that they are immune from the consequences of bankruptcy.

Secured creditors must still ultimately be concerned about the possibility that their actions will precipitate a bankruptcy. Despite the improvement of the secured party's prospects in bankruptcy under revised Article 9, bankruptcy judges will still have considerable latitude to determine the "equities of the case" and, in the process, to give the debtor some latitude to preserve its business. This is true even if the goal is liquidation, but the bankruptcy judge may second–guess the secured creditor's decision about the best way to maximize value in the liquidation of the business. Even if there is no equity in the property, the debtor may argue, under section 362(d)(2)(B), that the property is necessary for an effective reorganization. [392]

Creditors also have other reasons to exercise caution, as an economic downturn may produce an increase in litigation over "lender liability" or the equitable subordination of an overbearing creditor's position. The liability of a creditor for the debts of the debtor have tended to be limited to situations in which the creditor has dominated the management of the business. [393] Whether the evolution of lenders' control through revised Article 9 will produce another flood of such litigation in an economic downturn remains to be seen, but the history of the 1980's would suggest that lenders should not be insensitive to the issues.

Further empirical study of loan renegotiation under revised Article 9 will need to take several variables into consideration. Some of these can be foreseen or at least suggested, but future changes in the economic conditions in which such workouts occur must be considered carefully. On a macroeconomic level, it has already been noted that much of the development in the law and the financial industry has occurred during the prosperous years of the 1990's. It is entirely possible that an economic downturn will make it more difficult for troubled borrowers to find lenders willing to refinance their obligations. [394] On a microeconomic level, changes both in the economy and in financial industries may disrupt the relationship on which a successful loan renegotiation depends. The very phenomenon of increased securitization may have the effect of separating borrowers from their financing sources completely. [395] Even conventional lenders, under pressure to "tighten credit" may have less willingness to continue to negotiate an ongoing relationship with their borrowers. [396] There is also evidence that the financial industry is developing devices (including, but not limited to, the now–conventional practice of securitization) that will facilitate a lender's decision to withdraw from a credit, particularly if that decision is part of a larger effort to withdraw from lending to an industry segment. [397]

III.Conclusion

Transition is the current concern for practitioners facing a July 1, 2001 effective date. In learning the new rules, filing changes are the most obvious but they are only part of a larger pattern, designed to make it easier for secured creditors to protect themselves against attacks by bankruptcy trustees and to maintain control of troubled debtors' financial affairs, with legal controls that give them rights and powers before bankruptcy that will require all parties to workouts to reassess how they want to play the game.

There are many protections for the debtor and third parties in new Article 9 and other law. Both the parties and the policymakers, however, should appreciate the role of a carve–out in this situation. Between the parties, as a matter of assuring an orderly rehabilitation or liquidation, an agreement should be considered that would to make some funds available to pay costs, such as professional fees, inherent in the workout process. Such an agreement would serve the rational self–interests of the secured party in many situations. Policymakers and researchers should watch the practical effect of revised Article 9 during any time of tightened credit and continue to reflect on whether a pre–bankruptcy carve–out should be a part of the law of secured transactions. It is hoped that this article will provide some guidance in that analysis.

Appendix A

The Warren Proposal [398]

Proposal for Article 9 Set Aside

[Add language underlined:]

9−301. [399] Priority and Distribution

* * *

(4) Except as otherwise provided in subsection (5), a person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secured advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

(5) A person who becomes a lien creditor and levies while a security interest is perfected shall be entitled on account of such person's inferior judicial lien to receive from the proceeds of the collateral subject to such protected security interest an amount no great than 20 percent of the value of the property subject to the levy which is also subject to the security interest, if and only if

(a) the lien creditor gives notice of the intent to satisfy the lien to the person holding the perfected security interest at least ten days prior to the disposition of the property;

(b) the property levied upon is not consumer goods; and

(c) the person holding the perfected security interest is unable to protect the property subject to the security interest by compelling the lien creditor to marshal.

[Add new comment 9:]

9. Subsection (5) is intended to permit levying creditors to reach some value in property owned by debtors even if the debtor and one or more secured creditors have encumbered all the debtor's assets. The provision is added to respond to the concern that debtors and creditors make financing arrangements that have the effect of making a debtor judgment proof while it continues in business, so that the financer enjoys the benefits of the debtor's continuing business without sharing in the burden of the injuries the debtor may inflict on unsecured creditors. The provision benefits levying creditors only; its is unavailable to creditors who do not perform a judicial levy or have the rights of a levying creditor.

A secured creditor will be fully protected in many circumstances covered by this provision. If the secured creditor lends no more than 80 percent of the value of the property it takes as collateral, if the debtor has other unencumbered property which the lien creditors may reach to satisfy their judgments, if the debtor is sufficiently well−insured that no lien creditors will remain unpaid and attempt to seize the debtor's property, or if the debtor engages in a business that has few unsecured creditors, the secured creditor will be protected in full. A debtor who is able to operate only by encumbering all its property and borrowing amounts up to or beyond the full value of its property imposes substantial risks of non−payment on its unsecured creditors, who are often non−adjusting creditors. A secured creditor who lends in such circumstances may find that if the debtor is unable to pay its unsecured creditors, the secured creditor may lose a portion of the property it has encumbered.

Appendix B

Collateral Treated Differently

Under Revised Article 9

Collateral	*Article 9 Treatment*		Comment
	Former	***Revised***	
rights to payment for: · property disposed of other than by sale, lease or license · property licensed (e.g., fees & royalties from licenses of patents, copyrights, trademarks, software) · non–goods sold or leased · premium for issuance of insurance policy and surety bond premium · manufacturer's rebates · lottery winnings · provision of electricity	general intangibles	accounts	purchasers of accounts must still file financing statements in order to defeat lien creditors and trustees in bankruptcy
credit card receivables	unclear		
payment stream under real estate contract			
health care insurance receivables	non– Article 9		assignment to provider automatically perfected
payment intangible (general intangible where obligation is money payment)	general intangible	new sub–categories	no UCC–l must be filed by purchaser of payment intangibles or notes
promissory notes	instrument		
software embedded in goods	unclear	goods	inventory, equipment or consumer
other software	unclear	general intangible	
payments under letter of credit	proceeds of a letter of credit	letter of credit rights	perfect by control, not possession
deposit account	non– Article 9	new categories of collateral	only non–consumer, as original collateral; perfect by control
commercial tort claims			must arise from debtor's business, exist at time of security agreement and be specifically described
electronic chattel paper			perfect by "control" based on electronic identification method
supporting obligations (letters of credit, guaranties and other third–party enhancements)	unclear		automatically perfected by perfection of underlying security

rights under lease or license of collateral	unclear	new types of proceeds	no longer limited to proceeds of sale, exchange, collection or other disposition of collateral
claims arising out of defects in or damage to collateral	unclear		

FOOTNOTES:

[1] Member, Gullett, Sanford, Robinson & Martin, PLLC, Nashville, Tennessee; Adjunct Professor of Law, Vanderbilt University; Fellow, American College of Bankruptcy. The author wishes to express his appreciation for the ideas contributed by Prof. G. Ray Warner, Katherine S. Allen and his associate, David W. Houston, IV, as well as the comments of his colleagues, G. Rhea Bucy, Thomas H. Forrester and Linda W. Knight, on an earlier draft of this article. Back To Text

[2] Hereinafter "UCC." Back To Text

[3] To distinguish between the 1999 Official Text [hereinafter revised Article 9] and the 1972 version as amended since 1972 [hereinafter former Article 9], citations to former Article 9 as well as those to the pre−amendment versions of other UCC sections that now contain amendments conforming to the changes in revised Article 9 will be preceded by the word "former," e.g., "Former UCC § 9−___" or, for the pre−1972 version, "Former (1962) UCC § 9−___." Citations to revised Article 9 will be to the new section alone, e.g., "UCC § 9−___." Back To Text

[4] 11 U.S.C. § 101 et seq. (1994). Back To Text

[5] XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.), 16 F.3d 1443, 1445 (6th Cir. 1994) (attributing assessment of restaurant patrons' attitudes "to Woody Allen . . . but possibly dating from the Mesozoic Era."). Back To Text

[6] UCC § 9−701 et seq. Back To Text

[7] Several good sources focus on the critical issues of transition, including a two−part article authored by two members of the Drafting Committee to Revised Article 9. See, e.g., Harry C. Sigman & Edwin E. Smith, Revised U.C.C. Article 9's Transition Rules: Insuring a Soft Landing (pts. 1 & 2), 55 Bus. Law. 1065, 1763 (2000). A flow chart summarizing the steps necessary to stay perfected through the transition period is found in a useful pamphlet. See The New Article 9, 2000 A.B.A. Sec. Bus. L. 69 (2d ed.) [hereinafter "Aba New Article 9 Second"]. The author of the chart, who was the ABA advisor to the Drafting Committee, has also published and periodically updates it on the Internet, together with his own analysis of the transition rules and other materials. Steven O. Weise, Materials on the Revised Article 9, at http://www.hewm.com/ucc.pdf (last visited Jan. 26, 2001) [hereinafter Weise Internet Materials]. Back To Text

[8] See Marion W. Benfield, Jr., Consumer Provisions in Revised Article 9, 74 Chi.−Kent L. Rev. 1255 (1999). Because this article focuses on workouts in a commercial setting, for convenience, it will refer to non−consumer, business and commercial transactions interchangeably. The "consumer" aspects of revised Article 9 depend on a complex set of defined terms that, curiously, do not include a definition of "consumer". There are, however, definitions of "consumer goods" at § 9−102(a)(23), "consumer transactions," at § 9−102(a)(26), and "consumer−goods transactions," at § 9−203(a)(24). Benfield, supra note 8, at 1260. For those interested in the precise boundary at which some non−consumer rule ceases to apply, those definitions and Professor Benfield's article are valuable references. Back To Text

[9] See Linda J. Rusch, Farm Financing Under Revised Article 9, 73 Am. Bankr. L.J. 211 (1999). Back To Text

[10] For a good discussion of these dynamics, see Jean Braucher, Deadlock: Consumer Transactions Under Revised Article 9, 73 Am. Bankr. L.J. 83 (1999). Back To Text

[11] Hereinafter "ALI". Back To Text

[12] Hereinafter "NCCUSL". Back To Text

[13] Fred H. Miller, Introduction, U.C.C. Article 9 Symposium, 44 Okla. L. Rev. 1, 3 (1991). Back To Text

[14] Hereinafter "PEB". Back To Text

[15] Id. Back To Text

[16] UCC § 9–101 cmt. 2. Back To Text

[17] William C. Hillman, Introductory Note, Symposium On Revised Article 9 Of The Uniform Commercial Code, 73 Am. Bankr. L.J. XI (1999) (quoting Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group, U.C.C. Article 9, Report (Dec. 1, 1992)). Back To Text

[18] Robert M. Lloyd, The New Article 9: Its Impact on Tennessee Law (pt. 1), 67 Tenn. L. Rev. 125, 128–29 (1999) (citations omitted). See § 9–101 cmt. 2 (discussing the background and history of the PEB). Back To Text

[19] Memorandum from Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, to Council of the American Law Institute (Apr. 25, 1996) [hereinafter Warren Memorandum], in American College Of Bankruptcy Spring Meeting Education Program (March 8, 1997) (on file with author). Attached to the Warren Memorandum was a proposed change to former § 9–301, which is set forth infra as Appendix A and is hereinafter referred to as the "Warren Proposal". Back To Text

[20] According to Professor Warren's description of the December 1995 meeting of the Council of the ALI, "the operative metaphor" used at that meeting to describe the drafters' effort "was that the new proposals permitted the secured creditors 'to plow the corners of the field.'" Warren Memorandum, at 1. Back To Text

[21] See Warren Proposal, infra Appendix A. Back To Text

[22] 1 Grant Gilmore, Security Interests In Personal Property § 7.12, at 248–49 (1965); see also Grant Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman, 15 Ga. L. Rev. 605, 627 (1981) (asking "does it make any sense to award everything to a secured party who stands idly by while a doomed enterprise goes down the slippery slope into bankruptcy?"). Back To Text

[23] See Braucher, supra note 10, at 83. Professor Janger highlights the interplay of Article 9 in the Bankruptcy Code on real–world problems and focuses on the outside influences on drafting both. Edward J. Janger, The Locus of Lawmaking: Uniform State Law, Federal Law, and Bankruptcy Reform, 74 Am. Bankr. L.J. 97 (1999)[hereinafter Janger, The Locus of Lawmaking]. He finds an interesting contract in the ways interest group pressure affects federal legislation and uniform laws, with the former becoming more expansive (by the addition of special interest appendages) while the latter becomes narrower, to eliminate controversy. Id. at 108–09. Ultimately, Janger is critical of the uniform law drafting process, which he sees as being "captured" by special interests, resulting in a "race to the bottom." Edward J. Janger, Predicting When the Uniform Law Process Will Fail: Article 9, Capture and the Race to the Bottom, 83 Iowa L. Rev. 569 (1998) [hereinafter Janger, Predicting When the Process Will Fail]. See also Kathleen Patchel, Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code, 98 Minn. L. Rev. 83 (1983) (reviewing an enactability as a standard for drafting); Carlyle C. Ring, Jr., The UCC Process – Consensus and Balance, 28 Loy. L.A. L. Rev. 1802, 1816–19 (1994) (defending enactability standard); Allen Schwartz & Robert E. Scott, The Political Economy of Private Legislature, 143 U. Pa. L. Rev. 595, 651 (1995) (discussing "capture" of uniform drafting process by "powerful interests"). Back To Text

[24] Braucher, supra note 10, at 83 (quoting from proceeding of American Law Institute, 75th Annual Meeting, May 1998, 242 and transcript of July 1998 Annual Meeting, National Conference of Commissioners on Uniform State Laws and observing that "Burke's statement is typical of the general culture of the ALI–NCCUSL drafting process,

which recognizes that a uniform law cannot be enacted in fifty states over the opposition of a powerful interest group."). Back To Text

[25] The debate took as its starting point an article by the Reporters for the PEB Article 9 Study Committee. Steven L. Harris & Charles W. Mooney, Jr., A Property–Based Theory of Security Interests: Taking Debtors' Choices Seriously, 80 Va. L. Rev. 2021, 2021 (1994) (taking as their "'first principle' that Uniform Commercial Code Article 9 should facilitate the creation of security interests."). Several observers joined the debate following the publication of the Warren Memorandum. See, e.g., Kenneth N. Klee, Barbarians at the Trough: Riposte in Defense of the Warren Carve–Out Proposal, 82 Cornell L. Rev. 1466 (1997) (identifying six "macro–criticisms" of Warren Proposal and seeking to rebut each); Elizabeth Warren, Making Policy With Imperfect Information: The Article 9 Full Priority Debates, 82 Cornell L. Rev. 1373 (1997) (criticizing approach of ALI and inviting empirical approach to avoid monopolization of debate by secured lenders). Back To Text

[26] Janger, The Locus of Lawmaking, supra note 23, at 109 n.57. One creditor interest did join the debate. A critic, publishing his comments in a publication of the Commercial Law League of America, suggested, "It is as though the U.C.C. specialists identified with secured creditors as the Client, the Good Guys, whereas unsecured creditors are treated as the Adversaries, the Villains." Julian B. McDonnell, Is Revised Article 9 A Little Greedy?, 104 Com. L.J. 241 (1999). Back To Text

[27] The debate between drafters and carve–out advocates degenerated into ad hominem argument between those characterized by their adversaries as "the revisers" and, on the other side, Gilmore, Warren and others who question the rule of full priority. Two of the drafters referred critically to the latter group as the "sympathetic legal studies" movement (or "symps"), which they believed to be misguided. Harris & Mooney, supra note 25, at 2045–47. Back To Text

[28] Carl S. Bjerre, International Project Finance Transactions: Selected Issues Under Revised Article 9, 73 Am. Bankr. L.J. 261 (1999). Back To Text

[29] UCC § 9–701. Back To Text

[30] UCC § 9–701 cmt. Back To Text

[31] As the year 2001 began, the proposed legislation had been adopted in Alaska, Arizona, California, Delaware, District of Columbia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Montana, Nebraska, Nevada, North Carolina, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington and West Virginia and introduced in Arkansas, Colorado, Georgia, Massachusetts, Mississippi, Missouri, New Jersey, North Dakota, Oregon, U.S. Virgin Islands, Wisconsin and Wyoming. NCCUSL, Revised UCC Article 9, Secured Transactions (1999), at http://www.nccusl.org/uniformact_factsheets/uniformacts–fs–ucca9.htm (last visited Jan. 26, 2001). Back To Text

[32] See § 9–501 et. seq; see also discussion infra Part III.B.2. Back To Text

[33] See discussion infra Part III.A. Back To Text

[34] Former Article 9 contained only 55 sections; in contrast, the revision contains 126 sections, plus transitional rules and conforming amendments to other articles. Most of the provisions of revised Article 9 that are comparable to those of its predecessor have been reworded and re–numbered. In light of this multiplication and rearrangement, it should be noted that there are several reference tables that provide cross–references between versions by old and new section numbers. Two such tables, at the beginning of the ALI–NCCUSL proposal itself, are published in several places with that material. See, e.g., Aba New Article 9 Second, supra note 7, at 134–38. Another is a descriptive table of sections significantly changed by the revision. Steven O. Weise, A Comparison of Current and Revised Article 9, in id. at 107–29. The author of the latter table, who was the ABA advisor to the Drafting Committee, has also published and periodically updates it on the Internet, together with other materials. See Weise Internet Materials, supra note 7. Back To Text

[35] Former UCC § 9–115(1)(e). Back To Text

[36] See UCC § 9–104 (deposit account); id. § 9–105 (electronic chattel paper); id. § 9–106 (investment property); id. § 9–107 (letter–of–credit right). For deposit accounts, securities accounts and letter–of–credit rights, the depositary bank, securities intermediary or issuer (respectively) must be authorized to, and must affirmatively agree to, act on instructions from the secured party with respect to the collateral without further consent from the debtor. A secured party can alternatively achieve control over a deposit account (or investment account) if the secured party is the depositary bank (or securities intermediary) or if the account is in the secured party's name. Back To Text

[37] Former UCC § 9–305 (requiring, in passive voice, only that "the bailee receives notification of the secured party's interest"). Back To Text

[38] UCC § 9–313(c)(1). Back To Text

[39] UCC § 9–313(c)(2). Back To Text

[40] Several good summaries of all of these changes are available. See, e.g., Edwin E. Smith, Overview of Revised Article 9, 73 Am. Bankr. L.J. 1, 7 (1999). It is not the primary purpose of this article to catalog all of these changes in detail, but to emphasize the changes that will have the greatest effect on the workout process. A chart appears infra as Appendix B that highlights the collateral treated differently under revised Article 9. Back To Text

[41] See discussion infra Parts III.A.3 & IV.A.2. Back To Text

[42] See discussion infra Part III.A.1. Back To Text

[43] See discussion infra Part III.A.2. Back To Text

[44] See discussion infra Part III.A. Back To Text

[45] See discussion infra Part III.A.4. Back To Text

[46] See discussion infra Part III.B.1. Back To Text

[47] See discussion infra Part III.B.2. Back To Text

[48] See discussion infra Part III.B. Back To Text

[49] See discussion infra Part III.C.1. Back To Text

[50] See discussion infra Part III.D. Back To Text

[51] See id. Back To Text

[52] This fact and its effect on creditor behavior have been the subject of considerable attention. See, e.g., Robert K. Rasmussen, The Ex Ante Effects of Bankruptcy Reform on Investment Incentives, 72 Wash. U. L.Q. 1159 (1994) (providing thorough academic discussion of issue); Robert E. Scott, A Relational Theory of Secured Financing, 86 Colum. L. Rev. 901 (1986); Robert E. Scott, Rethinking the Regulation of Coercive Creditor Remedies, 89 Colum. L. Rev. 730 (1989); see also Ronald J. Mann, Strategy and Force In the Liquidation of Secured Debt, 96 Mich. L. Rev. 159 (1997). Mann's article is an effort to study empirically the issues raised by Professor Rasmussen and to build on the observations of Professor Scott. Back To Text

[53] See 11 U.S.C. § 541(a)(1994). Back To Text

[54] Id. § 541(d). Back To Text

[55] See Senate Comm. on the Judiciary, S. Rep. No. 95–989 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5869–70. Two articles, written at the time of the enactment reflect the litigation that prompted the last–minute addition to section 541. See Homer W. Drake & Kyle R. Weems, Mortgage Loan Participations: The Trustee's Attack, 52 Am. Bankr. L.J. 23 (1978); Mark E. MacDonald, Loan Participations as Enforceable Property Rights in Bankruptcy –– A Reply to the Trustee's Attack, 53 Am. Bankr. L.J. 35 (1979). Back To Text

[56] Debora L. Threedy, Loan Participations – Sales Or Loans? Or Is That the Question? 68 Or. L. Rev. 649, 655 (1989) (reviewing lines of case law and concluding "[t]he determination whether a participation is a sale or loan, therefore, is being made in the crucible of the common law, not as a matter of legislative decision."). It is this common law that revised Article 9 attempts to clarify. See Cohen v. Army Moral Support Fund (In re Bevill, Bresler & Schulman Asset Mgmt. Corp.), 67 B.R. 557 (D.N.J.), aff'd 805 F.2d 120 (3d Cir. 1986) (describing operation of "repo" markets in trading government securities and attempting to determine whether such transactions should be primarily characterized as sales or liens); Hatoff v. Lemons & Assocs., Inc. (In re Lemons & Assocs., Inc.), 67 B.R. 198 (Bankr. D. Nev. 1986) (distinguishing between legitimate purchases of participations in secondary mortgage market and ostensible purchases involving Ponzi scheme); Mark E. MacDonald, Camille R. McLeod & K. Steven Roberts, Executory Contracts: A Cheshire Cat Looks At The 1990s, 526 PLI/Comm 521 (1990). Back To Text

[57] A debtor in possession in a chapter 11 case is generally vested with the powers of a trustee. See 11 U.S.C. § 1107(a)(1994). Back To Text

[58] Id. § 544(a)(1)–(2). Note that paragraph (3) (omitted above) vests the trustee with the status of a bona fide purchaser from the debtor, but only as to real property and not as to fixtures. See id. § 544(a)(3). Back To Text

[59] UCC § 9–201(a). Back To Text

[60] Id. at subpt. 3. Back To Text

[61] UCC § 9–317(a)(1)(B). Back To Text

[62] UCC § 9–102(a)(52)(D). Back To Text

[63] See UCC § 9–205 cmt. 2 (discussing validation and history of "floating lien" on shifting collateral). Back To Text

[64] UCC § 9–205(a). Back To Text

[65] UCC § 9–204(a). The parties' intent to cover the after–acquired property in the security agreement may be implied. See § 9–108 cmt. 2. Back To Text

[66] 11 U.S.C. § 552(1994). Back To Text

[67] UCC § 9–204(c). Back To Text

[68] 11 U.S.C. § 364(c)–(d). Back To Text

[69] UCC § 9–315(a)(2). Back To Text

[70] 11 U.S.C. § 552(b)(1). Section 552(b)(1) provides:

[With exceptions for provisions] in sections 363, 505(c), 552, 554, 555, 547, and 548..., if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property, then such security interest extends to such proceeds, product, offspring, or profits acquired by the state after the commencement of the case to the extent provided by such security agreements and by applicable non–bankruptcy law, except to the extent that the court, after notice and a hearing and based on the

equities of the case, orders otherwise.

Id. The Bankruptcy Code contains no definition of proceeds. Back To Text

[71] 11 U.S.C. § 506(c). Back To Text

[72] See id. § 363(e); see also In re Addison Props. Ltd. P'ship, 185 B.R. 766, 769 (Bankr. N.D. Ill. 1995). Back To Text

[73] See In re Addison Props. Ltd. P'ship, 185 B.R. at 784 (describing split in authority and concluding that "dual evaluation approach is consistent with, if not required by, . . ." 11 U.S.C. § 506(a)). Back To Text

[74] See Charles D. Booth, The Cramdown on Secured Creditors: An Impetus Toward Settlement, 60 Am. Bankr. L.J. 69, 104–05 (1986) (reviewing effect of confirmation standards, 11 U.S.C. § 1129(b), on negotiating process). Back To Text

[75] See, e.g., In re Compton Impressions, Ltd., 217 F.3d 1256, 1259 (9th Cir. 2000). Compton involved an attempt by a chapter 11 debtor to surcharge a secured creditor's collateral under § 506(b) in a situation in which the secured creditor had agreed to a first cash collateral stipulation that earmarked money to be "carved–out" from the sale of units to be used for construction, marketing and sales expenses and for payments on a loan. See id. at 1259. In concluding that the debtor's attempted surcharge was excessive, the court observed that a "secured creditor's consent to the payment of designated expenses, limited in amount, is not a blanket consent to be charged with additional expenses not included in the consent agreement." Id. at 1261 (quoting In re Cascade Hydrolics & Util. Serv., Inc., 815 F.2d 546, 549 (9th Cir. 1987)). Back To Text

[76] See discussion infra Part III.A.2. Back To Text

[77] See discussion supra Part I.B. Back To Text

[78] See discussion infra Part IV. Back To Text

[79] See generally 11 U.S.C. § 363 (1994). Back To Text

[80] See id. § 1108. Back To Text

[81] Id. § 363(c)(1). Back To Text

[82] See id. § 363(b). Back To Text

[83] See id. § 363(c)(2). Back To Text

[84] See id. § 363(e). Back To Text

[85] See 11 U.S.C. § 365 (1994). Back To Text

[86] 1 David G. Epstein, Steve H. Nickles & James J. White, Bankruptcy § 5–1, at 439 (1992). Back To Text

[87] An important exception to the general rule of assignability arises where "applicable law" prohibits assignment of those contracts. See Brett W. King, Assuming and Assigning Executory Contracts: A History of Indeterminant "Applicable Law," 70 Am. Bankr. L.J. 95, 96–98 (1996). The non–assignability of contracts may have unexpected consequences. Relying on the statutory language of § 365(c)(1), which provides that the debtor may not "assume or assign" an executory contract if applicable law would preclude a debtor from assigning the contract to a third party without the consent of the non–debtor party, the majority of courts of appeals that have considered the issue bar a debtor in possession from assuming a non–assignable contract even if the debtor has no intention of assigning the contract to a third party. See, e.g., In re Catapult Entm't, Inc., 165 F.3d 747, 754–55 (9th Cir. 1999), cert. dismissed,

528 U.S. 924, 145 L. Ed. 2d 248, 120 S. Ct. 369 (1999); see also In re James Cable Partners, 27 F.3d 534, 537 (11th Cir. 1994) (characterizing § 365(c)(1)(A) as posing "a hypothetical question"); In re West Elec., Inc., 852 F.2d 79, 83 (3d Cir. 1988) (same); In re Catron, 158 B.R. 629, 633–38 (E.D. Va. 1993), aff'd without op., 25 F.3d 1038 (4th Cir. 1994) (same). In contrast, the First Circuit follows an "actual" test of whether the contract is to be assigned. See Inst. Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493 (1st Cir. 1997), cert. denied, 521 U.S. 1120, 117 S. Ct. 2511, 138 L. Ed. 2d 1014 (1997) (rejecting hypothetical test). The revision of Article 9 should minimize the number of other "applicable" laws that may interfere with the assignment of rights subject to Article 9 transactions. Back To Text

[88] See 11 U.S.C. § 365(e)(1). Back To Text

[89] See id. § 365(f)(1), (3); see also In re Standor Jewelers W., Inc., 129 B.R. 200, 203 (B.A.P. 9th Cir. 1991) (holding provision in lease requiring payment of proceeds from assignment to landlord unenforceable). Some courts have even gone so far as to hold that a provision restricting an assignee's use of the subject of the contract is an invalid restriction on the assignment. See In re U. L. Radio, 19 B.R. 537, 544 (Bankr. S.D.N.Y. 1982) (allowing sale of electronics store for use as restaurant). Back To Text

[90] See §§ 9–406, 9–408. Back To Text

[91] See discussion infra Part III.A.4. Back To Text

[92] See generally Steven L. Schwarcz, The Impact on Securitization of Revised UCC Article 9, 74 Chi.–Kent L. Rev. 947, 949–50 (1999) (assembling range of general authorities on this subject and presenting more complete picture of securitization industry). Back To Text

[93] See id. at 947–48. Back To Text

[94] This result turns largely on the language of § 541(d) of the Bankruptcy Code. See 11 U.S.C. § 541(d) (1994); see also supra notes 55 & 56 and accompanying text. But see David Gray Carlson, The Rotten Foundations of Securitization, 39 Wm. & Mary L. Rev. 1055, 1056 (1998) (suggesting that 11 U.S.C. § 541(a) is so broad as to enable the bankruptcy court to reach most securitizations); see also In re Kingston Square Assocs., 214 B.R. 713, 714 (Bankr. S.D.N.Y. 1997) (refusing to dismiss involuntary petition against remote entity where petitioning creditors had been actively solicited by debtor's principal, with effect of circumventing bankruptcy–remote provision). Back To Text

[95] See Former § 9–102(1)(b). Back To Text

[96] As state law, however, revised Article 9 cannot resolve the ambiguities in federal law related to assignments of and security interests in patents, copyrights and trademarks, to the extent that federal law preempts one of these areas. See UCC § 9–109(c)(1); see also infra note 164 and accompanying text. Back To Text

[97] See Donald J. Rapson, "Receivables" Financing Under Revised Article 9, 73 Am. Bankr. L.J. 133, 134 (1999). Back To Text

[98] UCC § 9–102(a)(2). See Rapson, supra note 97, at 135. Back To Text

[99] Under former Article 9, because an "account" was only generated by the sale or lease of goods or by services rendered, a credit card receivable evidencing a cash advance would be deemed a "general intangible." Former UCC § 9–106. Back To Text

[100] UCC § 9–102(a)(2). Under former Article 9, the payment rights under a contract to sell real estate might have been either a general intangible or excluded as a real estate transaction. Rusch, supra note 9, at 217 n. 29. Back To Text

[101] See UCC § 9–102(a)(1), (31). Back To Text

[102] See Rapson, supra note 97, at 136. Back To Text

[103] See UCC § 9–109(a)(3). Back To Text

[104] See UCC § 9–102(a)(47). Back To Text

[105] UCC § 9–102(a)(65). Back To Text

[106] UCC § 9–102(a)(61). This coverage has been circumscribed, however, in an attempt to exclude sales that are not financing transactions. See, e.g., UCC § 9–109(d)(4), (5) (excluding assignments only for collection and transfers that are part of larger sale of business). Back To Text

[107] See generally UCC § 9–102 cmt. 5.d. The process here was to take everything that was not chattel paper or an instrument and put it into the definition of account, so that the definition seems to become longer and longer. What is left over is intended to be only loan participations that are not evidenced by an Article 9 instrument. Back To Text

[108] James J. White & Robert S. Summers, Uniform Commercial Code § 21–6, at 55–56 (4th ed. rev. Art.9 Supp. 2000) [hereinafter White & Summers Article 9 Supplement]. Back To Text

[109] See Former UCC § 9–106. Back To Text

[110] See Former UCC § 9–102(1)(b). Back To Text

[111] See Former UCC § 9–106. Back To Text

[112] Rapson, supra note 97, at 137. Back To Text

[113] 995 F.2d 948 (10th Cir. 1993), cert. denied, 510 U.S. 993, 114 S. Ct. 554, 126 L. Ed. 2d 455 (1993). Back To Text

[114] See id. Back To Text

[115] White & Summers Article 9 Supplement, supra note 108, § 21–6, at 57 n.2. Back To Text

[116] See Rapson, supra note 97, at 140–41. Back To Text

[117] See id. Back To Text

[118] UCC § 9–318(a) (declaring that "[a] debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.") Back To Text

[119] UCC § 9–309(3), (4). Back To Text

[120] UCC § 9–505(a). Compare Former UCC § 9–408 with UCC § 9–505(a). Back To Text

[121] Paul M. Shupack, Making Revised Article 9 Safe for Securitizations: A Brief History, 73 Am. Bankr. L.J. 167, 180 (1999). Back To Text

[122] UCC § 9–315(a)(1). It remains unclear, however, whether conditioning the sale on the lender's receipt of proceeds will prevent the security interest from being cut off until the proceeds are received. UCC § 9–315 cmt. 2. Back To Text

[123] See UCC §§ 9–203(f), 9–315(a)(2). "The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by § 9–315 and is also attachment of a security interest in a supporting obligation for the collateral." UCC § 9–203(f). "Except as otherwise provided in [Article 9] and in § 2–403(2) . . . a security interest

attaches to any identifiable proceeds of collateral." UCC § 9–315(a)(2). Back To Text

[124] See UCC §§ 9–203(f), 9–315(a)(2). Back To Text

[125] See, e.g., Universal C.I.T. Credit Corp. v. Farmers Bank of Portageville, 358 F. Supp. 317, 325–27 (E.D. Mo. 1973). Back To Text

[126] UCC § 9–315 cmt. 3. Back To Text

[127] See UCC §§ 9–315(b)(1), (c)–(e), 9–336(c)–(d). Back To Text

[128] Former UCC § 9–315. Back To Text

[129] See UCC § 9–336(e)–(f). Back To Text

[130] UCC § 9–102(a)(64) states:

'Proceeds and,' except as used [as a verb] in § 9–609(b), means the following property: (A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; (B) whatever is collected on, or distributed on account of, collateral; (C) rights arising out of collateral; (D) to the extent of the value of collateral, claims arising out of the loss, non–conformity, or interference with the use of, defects or infringement of rights in or damage to, the collateral; or (E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the law for non–conformity of, defects or infringement of rights in, or damage to, the collateral.

Id. Back To Text

[131] See Former UCC § 9–306(1). Back To Text

[132] See UCC § 9–102(a)(64)(A). Back To Text

[133] See, e.g., In re Value–Added Communications, Inc., 139 F.3d 543 (5th Cir. 1998) (holding coins from pay telephones not to be proceeds). Back To Text

[134] See UCC § 9–102(a)(64)(E). Back To Text

[135] See id. Back To Text

[136] The courts struggled with former Article 9's narrower definition of proceeds to cover only "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." Former UCC § 9–306(1). The phrase "other disposition," however, struck some courts as being broad enough to encompass "any type of disposition, actual or construction." McLemore, Trustee v. Mid–South Agri–Chemical Corp. 41 B.R. 369, 372 n.2 (Bankr. M.D. Tenn. 1984) (applying phrase to cover federal payment–in–kind certificates of entitlement owing to debtors as following within scope of proceeds of corn crop they replaced). Of particular concern to the drafters was case law holding that, for example, post–petition cash dividends on stock subject to a pre–petition pledge might not be "proceeds" under § 552(b) of the Bankruptcy Code. See FDIC v. Hastie (In re Hastie), 2 F.3d 1042 (10th Cir. 1993). The phrase "whatever is collected on, or distributed on account of, collateral," found in § 9–102(a)(64)(B), is expressly intended to reject that conclusion, to the extent that it is dependent on the Article 9 definition of "proceeds." See UCC § 9–102 cmt. 13. This definitional scheme also means that collections on and distributions on account of "supporting obligations," defined as including various credit–support arrangements under § 9–102(a)(77), are proceeds. See id. "The definition of 'proceeds' no longer provides that proceeds of proceeds are themselves proceeds. That idea is expressed in the revised definition of 'collateral' in § 9–102. No change in meaning is intended." Id. Back To Text

[137] See UCC § 9–102(a)(64)(D). Back To Text

[138] See UCC § 9–102(a)(64)(C). Back To Text

[139] See UCC § 9–102(a)(12). Back To Text

[140] The definition of "fixtures" continues to turn on "real property law." UCC § 9–102(a)(41). Revised Article 9 does, however, attack one area of confusion by defining a "manufactured home," UCC § 9–102(a)(53), and addressing a "manufactured–home transaction" as a secured transaction. UCC § 9–102(a)(54). Back To Text

[141] UCC § 9–109(d)(11). Back To Text

[142] Id. Back To Text

[143] UCC § 9–109(b) ("Security Interest in Secured Obligation"). Back To Text

[144] The issue some courts have stated is whether the assignment of a mortgage note must be accompanied by an assignment of the underlying mortgage or deed of trust. See, e.g., In re Maryville Sav. & Loan Corp., 742 F.2d 413 (6th Cir. 1984), clarified on reconsideration, 760 F.2d 119 (1985). Now, according to the drafters, "it also follows from subsection (b) that an attempt to obtain or perfect a security interest in a secured obligation by complying with non–Article 9 law, as by an assignment of record of a real–property mortgage, would be ineffective. Finally, it is implicit from subsection (d) that one cannot obtain a security interest in a lien, such as a mortgage on real property, that is not also coupled with an equally effective security interest in the secured obligation." UCC § 9–109 cmt. 7 (rejecting In re Maryville Savings & Loan Corp. explicitly). Back To Text

[145] "The attachment of a security interest and a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien." UCC § 9–203(g). Back To Text

[146] "Perfection of security interest in collateral also perfects a security interest in a supporting obligation for the collateral." UCC § 9–308(d). Back To Text

[147] White & Summers Article 9 Supplement, supra note 108, § 21–7, at 59. The omission of real estate rents from Article 9 may reflect the drafters' perception that this stream of payments is not often the subject of securitization and so "existing practices" were left in place. See id. This may be unfortunate in light of the 1994 amendment of § 552(b) of the Bankruptcy Code, which broadly attempted to dispose of the issue of creation and perfection of security interest in rents by adding subparagraph (2) and omitting the troublesome reference to state law as a source of authority for approval of this type of payment stream. Thus, with certain exceptions:

if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 552(b)(2) (1994). Back To Text

[148] See Former UCC § 104(1). Back To Text

[149] Former UCC § 1–104 cmt. 7. Back To Text

[150] See Bruce A. Markell, From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9, 74 Chi.–Kent L. Rev. 963, 970–73 (2000). Back To Text

[151] Id. at 973. Back To Text

[152] See UCC § 9–102(a)(29) (defining "deposit account"); id. § 9–109(d)(13) (scope provision); see also UCC § 9–102(a)(26) (defining "consumer transaction"). Back To Text

[153] See UCC § 9–109(d)(10)(A). Back To Text

[154] See UCC § 9–203(b)(3)(D). Back To Text

[155] See UCC § 9–315(a)(2). Back To Text

[156] See UCC § 9–109(d)(13). Back To Text

[157] See UCC § 9–102(a)(26). Back To Text

[158] See UCC § 9–108(b). Back To Text

[159] Compare UCC § 9–102(a)(2), (42) with UCC § 9–102(a)(29). Back To Text

[160] See discussion supra Part II.D. Back To Text

[161] See UCC §§ 9–406, 9–408. Back To Text

[162] See UCC § 9–406. Back To Text

[163] See Former UCC § 9–318. Back To Text

[164] See UCC § 9–109(c)(1) (providing that Article 9 "does not apply to the extent that . . . a statute, regulation, or treaty of the United States preempts this article . . . ."). Comment 8 to § 9–109 states:

Former Section 9–104(a) excluded from Article 9 "a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." Some (erroneously) read the former section to suggest that Article 9 sometimes deferred to federal law even when federal law did not preempt Article 9. [Revised] Subsection (c)(1) recognizes explicitly that this Article defers to federal law only when and to the extent that it must––i.e., when federal law preempts it.

Id.

The assignability of federal health plan payments, such as Medicare payments, has been problematic in bankruptcy. See, e.g., Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.), 973 F.2d 1065 (3d Cir. 1992) (addressing issues of automatic stay, setoff, recoupment by Department of Health and Human Services). Several reported cases suggest that a security interest in such payments may be valid, but the secured party's rights will at least be subject to any rights of recoupment that the federal agency might have. See, e.g., Wilson v. First Nat'l Bank (In re Missionary Baptist Found. of Am., Inc.), 796 F.2d 752 (5th Cir. 1986) (considering whether lender obtained preferential transfers of assigned benefits); In re Alliance Health of Fort Worth, Inc., 240 B.R. 699, 704 (N.D. Tex. 1999) (holding that security interest in right to receive payments could "transfer to assignee no greater right or interest than was possessed by the assignor"). Assuming that revised Article 9 applies to payments of such federal health plans as health–care–insurance receivables, it "enables a security interest to attach to letter–of–credit rights, health–care–insurance receivables, promissory notes, and general intangibles, including contracts, permits, licenses, and franchises, notwithstanding a contractual or statutory prohibition against or limitation on assignment," but "explicitly protects third parties against any adverse effect of the creation or attempted enforcement of the security interest. See Sections 9–408, 9–409." UCC

§ 9–101 cmt. 4. Back To Text

[165] See UCC § 9–406 cmt. 5. Back To Text

[166] In passing, it should be said that practitioners will need to be aware of these overrides of restrictions upon assignments and the implication that they have for enforceability opinions. In transactions that today bear no relationship to financing, there may be restrictions on assignments by one side or another and, to the extent those provisions are present, Article 9 may override those to some extent. The practitioner thus should consider qualifying opinions in contexts in which one might not have considered Article 9, although this was to some extent the law already, unless the restriction is imposed by law. See Former UCC § 9–318. Back To Text

[167] Former UCC § 9–318(4) (invalidating such provisions in accounts and in general intangibles that were rights for money due or to become due). Back To Text

[168] See UCC § 9–406. Back To Text

[169] See id. Back To Text

[170] See UCC § 9–406(d), (f). Back To Text

[171] See UCC § 9–406(d), (f). Back To Text

[172] See UCC § 9–408(d); id. § 9–408 cmt. 6. Back To Text

[173] See UCC § 9–408(d)(6). Back To Text

[174] See id. Back To Text

[175] See UCC § 9–408(d)(5). Back To Text

[176] See MLQ Investors L.P. v. Pac. Quadracasting, Inc., 146 F. 3d 746 (9th Cir. 1998), cert. denied, sub nom, Heusser v. MLQ Investors, 525 U.S. 1121, 119 S. Ct. 903, 142 L. Ed. 3d 902 (1999) (distinguishing between license and proceeds and validating secured party's rights in proceeds). Back To Text

[177] See, e.g., In re Delgado, 967 F.2d 1466 (10th Cir. 1992); In re Amereco Envtl. Servs., Inc., 129 B.R. 197 (Bankr. W.D. Mo. 1991). Back To Text

[178] Various provisions in executory contracts and unexpired leases that prohibit the assignment of such contracts in bankruptcy are not effective. See 11 U.S.C. § 365(e)–(f) (1994); see also discussion supra Part II.D. Back To Text

[179] Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 117 S. Ct. 1879, 138 L. Ed. 3d 148 (1997). Back To Text

[180] See UCC § 9–203(a). Back To Text

[181] See UCC § 9–203(b). Back To Text

[182] See UCC § 9–213. Back To Text

[183] See UCC § 8–301. Back To Text

[184] See UCC § 9–314. Back To Text

[185] See UCC § 9–102 cmt. 9. Back To Text

[186] "A 'record' includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be 'written' 'in writing' or otherwise in tangible form do not necessarily reflect or aid commercial practices." Id. Back To Text

[187] "'Authenticated' replaces and broadens the definition of 'signed,' in Section 1–201, to encompass authentication of all records, not just writings." Id. Back To Text

[188] See id. Back To Text

[189] See, e.g., UCC §§ 9–203(b)(3)(A), 9–502(a). Back To Text

[190] See UCC § 9–203(b)(3)(A). Back To Text

[191] See UCC § 9–102(a)(7)(B). Back To Text

[192] See UCC § 9–102 cmt. 9. Back To Text

[193] Id. Back To Text

[194] See UCC §§ 9–102(a)(73), 9–203(b)(3)(A). Back To Text

[195] See UCC § 9–203(b)(3)(A). Back To Text

[196] See UCC § 9–108(b). Back To Text

[197] See UCC § 9–108(c). Back To Text

[198] See UCC § 9–204(a). Back To Text

[199] See UCC § 9–204(b)(2). Back To Text

[200] See UCC § 9–108(e)(1). Back To Text

[201] See UCC § 9–204(b)(2). Back To Text

[202] See UCC § 9–108 cmt. 5. Back To Text

[203] Former UCC § 9–401(1) set out a smorgasbord of three, increasingly complex filing systems from which states might choose. A state's version determined which transactions required local rather than central filing. Despite the Code's provision of three alternative versions, states also adopted a significant number of nonuniform variations. At some points, even the drafters threw up their hands. "Alternative 3" of Former UCC 9–401(1) established a dual filing requirement for debtors who had only one place of business in the state or for residents who had no place of business in the state. When the number of places of business increased, however, the cumbersome, local system was abandoned in favor of a single, central filing. Back To Text

[204] See Former UCC § 9–103(1)(b). Back To Text

[205] See Former UCC § 9–103(3). Back To Text

[206] See UCC § 9–301. Back To Text

[207] See Former UCC § 9–401. Back To Text

[208] See UCC § 9–301(3). Back To Text

[209] See UCC § 9–307(e). Back To Text

[210] See Former UCC § 9–103(3)(d). Back To Text

[211] See UCC § 9–307(b)(2). Back To Text

[212] See UCC § 9–307(b)(3). Back To Text

[213] See UCC § 9–307(b)(1). Back To Text

[214] See UCC § 9–307(c). Back To Text

[215] See UCC § 9–521. Back To Text

[216] See UCC § 9–521(a). Back To Text

[217] See UCC § 9–521(b). Back To Text

[218] See UCC § 9–509. Back To Text

[219] See UCC § 9–509(b). Back To Text

[220] See UCC § 9–509(a)(1). Back To Text

[221] Sigman, supra note 7, at 68. Back To Text

[222] See UCC § 9–516(a). Back To Text

[223] See UCC § 9–502. Back To Text

[224] See UCC § 9–516(b). Back To Text

[225] See UCC § 9–516(d). Back To Text

[226] See 11 U.S.C. § 544(a) (1994) (depriving trustee of status of purchaser as to personal property). Back To Text

[227] See UCC § 9–502(a). Back To Text

[228] See UCC § 9–516(b)(5). Back To Text

[229] Even if there is a UCC § 9–516(b)(5) error (omitting required debtor–related information), the security interest fails only against a conflicting secured party or purchaser and only to the extent that those competitors lend or take the collateral for value, in reasonable reliance upon the incorrect information and, in the case of a purchaser of chattel paper, documents, goods, instruments or a securities certificate, take delivery of the collateral. See §§ 9–520(c), 9–338. So, the filing may be attacked, but only in limited circumstances and not by the trustee in bankruptcy. Back To Text

[230] White & Summers Article 9 Supplement, supra note 108, § 22–11, at 110. Back To Text

[231] See, e.g., Krystal Hill v. The Farmers & Merchants Bank of Waterloo, 641 So.2d 788 (1994). Back To Text

[232] See UCC § 9–503. A registered organization (i.e., organized under a law requiring the jurisdiction to maintain a public record of its organization, § 9–102(a)(70)) must be identified as its name appears on the public record. See id. § 9–503(a)(1). Of course, with filing in the same office, due diligence becomes less problematic. There are also detailed requirements for identifying decedents' estates, § 9–503(a)(2), and trusts. See id. § 9–502(a)(3). For other debtors, the individual's name or the name of the entity, if it has one, must be provided and if an organization has no name, the financing statement must name its "partners, members, associates or other persons comprising the debtor." Id. § 9–503(a)(4). A trade name or other supplemental information is permissible but, without the correct name, is not sufficient. See id. § 9–503(b)–(c). Back To Text

[233] See UCC § 9–506(a). Back To Text

[234] See UCC § 9–506(b). Back To Text

[235] See UCC § 9–506(c). Back To Text

[236] See UCC § 9–503(d). Back To Text

[237] See UCC § 9–503 cmt. 3. The named secured party of record, however, is the only party who can authorize the amendment of the financing statement. See § 9–511. Back To Text

[238] See UCC § 9–502(a). Back To Text

[239] See UCC § 9–504(2). Back To Text

[240] See UCC § 9–108(c). Back To Text

[241] See UCC §§ 9–520(c), 9–338. Back To Text

[242] See UCC § 9–338. Recall that the trustee in bankruptcy is not a secured party or a purchaser as to personal property. See 11 U.S.C. § 544(a) (1994). Back To Text

[243] Revised Article 9 continues with some adjustments in its predecessor's rules for purchase of goods in the ordinary course of the debtor's business, even if the customers have knowledge of the security interest. See UCC §§ 9–201(9), 9–320(a). Back To Text

[244] See UCC §§ 9–315(a)(1), 9–507(a). Back To Text

[245] See UCC § 9–323(d). If the security interest is unperfected, the buyer for value and without knowledge of the security interest will generally prevail. See UCC § 9–317(b). Back To Text

[246] See UCC § 9–315(a)(1). Back To Text

[247] Former UCC § 9–306(2). Back To Text

[248] See, e.g., In re Cohutta Mills, Inc., 108 B.R. 815, 818 (N.D. Ga. 1989)(reviewing authorities and reading former Article 9 "as providing that a security interest terminates upon the transfer of the collateral unless the secured creditor unambiguously authorized the disposition subject to its security interest."). Back To Text

[249] See UCC § 9–317(b). Back To Text

[250] See, e.g., Aircraft Trading & Servs., Inc. v. Braniff, Inc., 819 F.2d 1227 (2d Cir. 1987). Back To Text

[251] See UCC § 9–312(b)(1); see also supra note 36 and accompanying text. Control over a deposit account can be acquired in three ways. The depository bank itself has automatic control and, therefore, perfection and should lead a

bank to consider adding a grant of a security interest into its standard account agreement. See UCC § 9–104(a)(1). Next, and perhaps likely to become the most common method, the secured party and the depository bank can enter into a "control agreement," whereby the debtor, the secured party and the bank agree in an authenticated record that the depository bank will comply with the secured party's instructions to pay out the funds on deposit without further consent by the debtor being required. See UCC § 9–104(a)(2). Finally, it is possible for the secured party to obtain control by becoming the depository bank's customer on the account. See UCC § 9–104(a)(3). Back To Text

[252] See UCC § 9–104(b). Back To Text

[253] See Former UCC § 9–305. Back To Text

[254] As with deposit accounts, there is a special provision in revised Article 9 defining control for the purpose of perfecting a security interest in a letter–of–credit right. In this instance, the issuer or nominated person must consent "to an assignment of proceeds of the letter of credit under § 5–114(c) or otherwise applicable law or practice." UCC § 9–107. Back To Text

[255] See Former UCC § 9–104(g). Back To Text

[256] See UCC § 9–109(d)(8). Back To Text

[257] See UCC § 9–102(a)(2). Back To Text

[258] See UCC § 9–102(a)(46). Back To Text

[259] Revised Article 9 does not make it clear whether the phrase "health–care–insurance" might include federal health care payments under health care plans such as Medicare. See In re Bell, 29 F.3d 627 (8th Cir. 1994) (applying assignment of "insurance proceeds," to payments from health plan in unpublished, per curiam opinion). Back To Text

[260] See supra note 164 and accompanying discussion of the interplay of Article 9 and federal law. Back To Text

[261] See UCC § 9–309(5). Back To Text

[262] See Former UCC § 9–104(k). Back To Text

[263] See UCC § 9–109(d)(12). Back To Text

[264] See UCC § 9–102(a)(13). Back To Text

[265] See UCC § 9–310(a). Back To Text

[266] See UCC § 9–108(e). Back To Text

[267] See UCC § 9–108 cmt. 5; see also supra notes 200–02 and accompanying text. Back To Text

[268] See UCC § 9–310(a) (providing that, first, one must have attachment and then may have to meet certain "requirements" to perfect, of which filing is most common requirement). Other forms of filing or registration pursuant to other statutes than the UCC are envisioned by § 9–302(3) and, because they do not change former law substantially, those rules are largely beyond the scope of this article. The policy in such cases is to recognize that there are suitable alternative systems for giving public notice of a security interest. These systems have public recognition, so that, for example, most people buying automobiles know to find out where the title is, to get it transferred to them and, in the process to have prior liens released. Back To Text

[269] Sigman, supra note 7, at 61. Back To Text

[270] See id. Back To Text

[271] See UCC § 9–504(2). Back To Text

[272] See Former UCC § 9–402(1). Back To Text

[273] See UCC § 9–203(b)(3). Back To Text

[274] See UCC § 9–108(b). Back To Text

[275] See Former UCC § 9–304(1) (including, notably, instruments that were not part of chattel paper). Back To Text

[276] See Former UCC § 9–116(4)(b). Back To Text

[277] See UCC § 9–312(a). Back To Text

[278] See id. Back To Text

[279] See UCC § 9–330. Back To Text

[280] See UCC § 9–310(a). Back To Text

[281] See Former (1962) UCC § 9–401(1). Back To Text

[282] See id. Back To Text

[283] See Richard E. Speidel, Robert S. Summers & James J. White, Secured Transactions Teaching Materials 287 (5th ed. 1993). Back To Text

[284] Because the trustee has the status of a bona fide purchaser of real estate and not merely a hypothetical lien creditor, Congress added an exclusionary reference to fixtures to § 544(a)(3) in 1984, to make this outcome clear. This insured that the trustee would remain lien creditor as to this personal property (even if it was affixed to real estate). The 1972 improvement of Article 9, however, continued to engender the confusion that arises from such a multi–layer perfection process. The creditor is always perfected if it does a UCC filing but the creditor is protected with a fixture filing only if it guesses right about the status of the collateral as a fixture. Unfortunately, some may still draw the conclusion that one should perfect every way in which it might be helpful. Back To Text

[285] See Former (1962) UCC § 9–305. Back To Text

[286] 4 James J. White & Robert S. Summers, Uniform Commercial Code § 31–12, at 180 (4th ed. 1995) [hereinafter White & Summers]. Back To Text

[287] See supra notes 92–94, 108–21 and accompanying text. Back To Text

[288] For example, perfection of a security interest in an "instrument" may now be achieved by filing as well as by possession. See UCC § 9–312(a). As with investment property, however, a creditor with such collateral perfected only by filing will generally lose to a purchaser or a creditor perfected by possession or control. See UCC §§ 9–317(b), 9–328(1). Back To Text

[289] See UCC § 9–317(a)(2)(A). Back To Text

[290] See UCC § 9–517. Back To Text

[291] See UCC § 9–517 cmt. 2. Back To Text

[292] See UCC § 9–515(b). Back To Text

[293] See id. Back To Text

[294] See UCC § 9–515(f). Back To Text

[295] See UCC § 9–515(g). Back To Text

[296] See UCC § 9–515(c). "Under former Section 9–402(2), lapse was tolled if the debtor entered bankruptcy or another insolvency proceeding. Nevertheless, being unaware that insolvency proceedings had been commenced, filing offices routinely removed records from the files as if lapse had not been tolled." UCC § 9–515 cmt. 4. In 1994, Congress attempted to assist secured parties amending the statutory automatic stay of § 362, to allow filing of a continuation statement despite the pendency of the automatic stay. 11 U.S.C § 362(b)(3)(1994). Revised Article 9's removal of the tolling provision completes the legislative process in our federal system and, consistent with the revised Bankruptcy Code, allows filing of a financing statement before the routine date of lapse. Back To Text

[297] See UCC § 9–522. Back To Text

[298] See UCC § 9–324. Back To Text

[299] Compare Former UCC § 9–107 with UCC § 9–103(a)(2). Back To Text

[300] See, e.g., In re Manuel, 507 F.2d 990 (5th Cir. 1975) (applying rule in consumer transaction). Back To Text

[301] See UCC § 9–103(f). Back To Text

[302] See UCC § 9–103 cmt. 7. Back To Text

[303] See UCC § 9–103(a)(1). Back To Text

[304] See UCC § 9–103(c). Back To Text

[305] See UCC § 9–609(b)(2). There continues to be no definition of "breach of the peace." See UCC § 9–609 cmt. 3. Back To Text

[306] See UCC § 9–623. The distinctions between parties to a transaction involving a security interest are very important in this context. The "debtor" is a person who has an ownership or other interest in the collateral, other than a security interest or a lien. § 9–102(a)(28). A "secondary obligor" is a party other than a primary obligor, accountable to pay or perform the secured obligation, § 9–102(a)(71)(A), and is included in the definition of an obligor, § 9–102(a)(59)(iii). Obligors other than the debtor and secondary obligors are often not directly affected by the rules in Part 6. Back To Text

[307] Compare Former UCC § 9–502(1) with UCC § 9–607; see also UCC § 9–102(a)(3). Back To Text

[308] See UCC § 9–607(a)(3). Back To Text

[309] See UCC § 9–607(e); see also supra notes 161–75 and accompanying discussion of the parallel provisions of UCC §§ 9–406 and 9–408. Back To Text

[310] Compare Former UCC § 9–503(3) with UCC § 9–613(1)(E). Back To Text

[311] See UCC § 9–613(1)(A)–(D). Back To Text

[312] See UCC § 9–613(5). Back To Text

[313] See UCC § 9–613(3). Back To Text

[314] See UCC § 9–611. Back To Text

[315] See UCC § 9–611(c)(3). Back To Text

[316] See UCC § 9–611(c)(3)(A). Back To Text

[317] See UCC § 9–611(c)(3)(B)–(C). Back To Text

[318] See UCC § 9–611(e). Back To Text

[319] See UCC § 9–611(c)(3)(A). Back To Text

[320] See UCC § 9–611(b). Back To Text

[321] See UCC § 9–611(d) (excepting "collateral that is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market."). Back To Text

[322] See UCC § 9–612(b). Back To Text

[323] See UCC § 9–609(a). Back To Text

[324] See UCC § 9–610(a). Back To Text

[325] See UCC § 9–610(b). Back To Text

[326] See UCC § 9–610(d). Back To Text

[327] See UCC § 9–610(e). Back To Text

[328] See UCC § 9–610(b). Back To Text

[329] See UCC § 9–615 cmt. 6. Back To Text

[330] See UCC § 9–615(f). Back To Text

[331] See UCC § 9–619. Back To Text

[332] See UCC § 9–619(a). Back To Text

[333] See UCC § 9–619(b). Back To Text

[334] See UCC § 9–619(c). Back To Text

[335] See UCC § 9–619 cmt. 3. Back To Text

[336] See Former UCC § 9–505. Back To Text

[337] See UCC § 9–620(a)(3). Back To Text

[338] See UCC § 9–620(c)(1). Back To Text

[339] See UCC § 9–620(b)(1). Back To Text

[340] See UCC § 9–620(c)(2)(C). Note that the twenty–day period includes the time for the proposal to be delivered to the debtor and for any objection to be delivered to the secured party. Back To Text

[341] See UCC § 9–621(a)(1). Back To Text

[342] See UCC § 9–621(a)(2) (covering parties with proper filings in the proper filing office under the proper name); § 9–621(a)(3) (covering parties who perfected under some other statute, regulation or treaty). Back To Text

[343] See UCC § 9–611(e); see also supra note 318 and accompanying discussion. Back To Text

[344] See UCC § 9–620(a)(2). Back To Text

[345] See UCC § 9–620(d). Back To Text

[346] See UCC § 9–620(c)(1). Back To Text

[347] See UCC § 9–621(b). Back To Text

[348] See UCC § 9–620 (adding a requirement that the proposal or consent be authenticated by the secured party). Back To Text

[349] See UCC § 9–626(a)(1)–(2). Back To Text

[350] See UCC § 9–626(a)(3)–(4). Note, however, that there is a separate rule, even for a commercially reasonable sale, if the sale was to a related party. See UCC § 9–615(f); see also supra note 330 and accompanying text. Back To Text

[351] See, e.g., Crocker Nat'l Bank v. Emerald, 221 Cal.App.3d 852, 270 Cal.Rptr. 699 (1990). Back To Text

[352] See supra notes 194–97 and accompanying text. Back To Text

[353] See supra notes 194–97 and accompanying text. Back To Text

[354] See UCC § 9–401(b). Back To Text

[355] See discussion supra note 75 and accompanying text. Back To Text

[356] UCC § 9–332 (italics added). Back To Text

[357] See UCC § 9–332 cmt. 4. Back To Text

[358] See UCC §§ 8–115, 8–503(e). Section 8–115 governs the liability of a securities intermediary and subsection (2) states that an intermediary will be liable to an adverse claimant of a financial asset where the intermediary acted in collusion with a wrongdoer in violating the rights of the adverse claimant. Section 8–503(e) governs the liability of a transferee who takes from a securities intermediary. A transferee is liable where the transferee acts in collusion with the securities intermediary in violating the securities intermediary's obligations to adverse claimants. UCC § 8–503(e). Back To Text

[359] See UCC § 9–332 cmt. 4. The drafters compare the collusion standard with § 1–201(9), "without knowledge that the sale . . . is in violation of the security interest"; section 1–201(19), "honesty in fact in the conduct or transaction concerned"; and § 3–302(a)(2)(v), "without notice of any claim." The comment suggests these other standards are more stringent than the collusion standard. Back To Text

[360] See 7A William D. Hawkland & James S. Rogers, Collusion Standard, HAWKLAND UCC SERIES [Rev] 8–503, 10 [hereinafter Hawkland]. The Restatement (Second) of Torts § 976, entitled "Persons Acting in Concert," mandates

liability for an individual if he or she:

(a) does a tortious act in concert with another or pursuant to a common design with him;

(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance and encouragement; or

(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of a duty to the third person. Back To Text

[361] See Hawkland, supra note 360 (citing UCC § 8–503 cmt. 3). Back To Text

[362] See UCC § 8–503 cmt. 3. Back To Text

[363] See Hawkland, supra note 360. Back To Text

[364] See id. Back To Text

[365] See id. Examples appear, however, that illustrate some situations in which a transferee can be found liable under the collusion standard without the transferee having knowledge of an adverse claim. Id. Back To Text

[366] See id. Back To Text

[367] See id. Back To Text

[368] Id. Back To Text

[369] The collusion standard was present and has previously been addressed in the context of proceeds under former Article 9. See § 9–306 cmt. (2). The cases that have interpreted § 9–306 have held that, while a secured party is generally entitled to cash proceeds, transferees of such proceeds take free of any claim of the secured party except in situations where the transferee was not in the ordinary course or the transferee acted in collusion with the debtor to defraud the secured party of such cash proceeds. See, e.g., Harley–Davidson Motor Co. v. Bank of New England, 897 F.2d 611 (1st Cir. 1990). The proceeds cases allow a secured party to trace proceeds where it is found that the transferee acted in collusion with the debtor. Id. One such case involved a debtor whose deposit account was insufficient to pay off both a secured creditor and the bank where the deposit account was located. The debtor instructed the bank to set off the amount of money owed to the bank, which the bank did with full knowledge of the circumstances and after regular banking hours. See Universal C.I.T. Credit Corp. v. Farmers Bank of Portageville, 358 F. Supp. 317, 323–24 (E.D. Mo. 1973). The bank's actions in the Universal C.I.T. Credit Corp. case constituted collusion. However, one can imagine circumstances in which the collusion will not be so clear in transfers that come under the new § 9–332. Back To Text

[370] Earl F. Leitess & Steven N. Leitess, Inventory Financing Under Revised Article 9, 73 Am. Bankr. L.J. 119, at 123 n. 26 (1999). Back To Text

[371] See UCC § 9–315 cmt. 2 (observing that "the secured party may . . ., in an appropriate case, maintain an action for conversion."). Back To Text

[372] One study stands out. Mann, supra note 52. In it, Professor Mann builds on some excellent theoretical work. Robert E. Scott, A Relational Theory of Secured Financing, 86 Colum. L. Rev. 901 (1986) [hereinafter Scott, Relational Theory]; see also Robert E. Scott, Rethinking the Regulation of Coercive Creditor Remedies, 89 Colum L. Rev. 730 (1989) [hereinafter Scott, Coercive Creditor]. Mann tests Scott's suggestion that the function of creditor remedies is leverage rather than forced liquidation: "Security is taken for its active rather than its possible properties." Mann, supra note 52, at 160 n.2 (quoting Scott, Relational Theory, at 950). Mann also builds on academic analysis of "the ex ante effects of bankruptcy on the credit market." Mann, supra note 52, at 161 n.7. Of these studies, one stands out as the most exhaustive. Id. at 162 n.7 (citing Robert K. Rasmussen, The Ex Ante Effects Of Bankruptcy Reform

On Investment Incentives 72, Wash. U.L.Q. 1159 (1994)). Back To Text

[373] Of a sampling of insurance company workouts, 85% were resolved by agreement while 15% (three cases) went into involuntary liquidation. Mann, supra note 52, at 206–07. Of the involuntary liquidations, one was ineligible for bankruptcy, one went into chapter 11, and one resulted in "lender liability" litigation with an ultimate one–third reduction of the balance. Id. Back To Text

[374] Mann, supra note 52, at 192. Back To Text

[375] See id. at 196. Back To Text

[376] Id. at 193. This is consistent with industry–wide data. A study of loans closed 1996–2000 indicated that 38% of them were repaid by the end of the year following closing, while a cumulative total of 97% of such loans were repaid by the end of the fourth year following the date of closing. Standard & Poor's, S&P/Portfolio Management Data, at http://<www.pmdzone.com (last visited Feb. 6, 2001). Back To Text

[377] "Lending standards are being tightened at a faster clip than at any time in the last 10 years, including the 1990–91 recession," according to a Federal Reserve survey of senior bank loan officers, reported as this article was being written. Greg Ip, Bankers Put Tighter Controls On Loans, Wall St. J., Feb. 6, 2001, at A2. Back To Text

[378] See Marshall E. Tracht, Reorganization and Secured Credit: Explaining the Equity of Redemption, 52 Vand. L. Rev. 599, 623 (1999). Back To Text

[379] See id. at 623–26. Back To Text

[380] See id. at 626. Back To Text

[381] See id. at 626–27. Back To Text

[382] See id. at 627. Back To Text

[383] It delays foreclosure at least briefly and thus allows time for negotiation. Id. at 632. It also gives the debtor a potentially "valuable bargaining chip." Id. at 633. Further, it mitigates the "bilateral monopoly" problem when there is actual equity value in the property, because the lender has a diminished ability to seize that value by opportunistic foreclosure. Id. at 634. There are also openings for opportunism on the part of the debtor, however, as the borrower may consider threatening default to secure a workout. Id. at 634. Back To Text

[384] See id. at 604 n.18. Back To Text

[385] See UCC § 9–623(a), (c). Back To Text

[386] See UCC § 9–623(b). Back To Text

[387] See UCC § 9–624(c). Revised Article 9 also includes a number of other protections for debtors and obligors that cannot be waived. See id. § 9–602. While waiver of redemption is allowed after default, § 9–602's catalog of protections certainly may preserve some negotiating position for the debtor in a workout process. The rights and duties that may not be waived relate to standards in the following areas:

· Liability for failure to comply with the secured party's duties under sections 9–625 & 9–626;

· Strict foreclosure, although Revised Article 9 contains a new procedure for partial strict foreclosure and some rights and duties can be waived after default, under sections 9–620–22;

· Calculation of a surplus or deficiency when a secured party, a related person or a secondary obligor is the recipient of a disposition under section 9–615(f);

· Explanation of the calculation of a surplus or deficiency under section 9–616;

· Notice of dispositions of collateral, although the right to such notice can be waived after default [UCC §§ 9–610(b), 9–611 to –14.];

· Repossession without breach of the peace under section 9–609;

· Accounting for or paying surplus proceeds of collateral under sections 9–608(a) and 9–615(d);

· The application of non–cash proceeds of collection, enforcement or disposition under sections 9–608(a) and 9–615(c);

· Collection and enforcement of collateral under section 9–607(c);

· The right to request an accounting, a list of collateral and a statement of account under sections 9–210 and 9–504(2); and

· A secured party's duties in the use and operation of collateral under section 9–207(b)(4)(C).

It should also be noted, however, that § 9–603 provides:

AGREEMENT ON STANDARDS CONCERNING RIGHTS AND DUTIES.

(a) [Agreed standards.] The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in Section 9–602 if the standards are not manifestly unreasonable.

(b) [Agreed standards inapplicable to breach of peace.] Subsection (a) does not apply to the duty under Section 9–609 to refrain from breaching the peace.

Id. Back To Text

[388] Revised Article 9 also "enhances the lender's option of retaining the collateral in satisfaction of the debt." Rodney Clement, Revised Article 9 and Real Estate Foreclosures, 12 Prob. & Property 40, 44 (Oct., 1998). Partial satisfaction in strict foreclosure adds another device by which the secured party may strike at the debtor's equity in the property and was the subject of extended debate in the drafting process. See, e.g., Alvin C. Harrell, 1994 Meetings Refine Proposed Article 9 Revisions, 48 Consumer Fin. L.Q. Rep. 326, 330 (1994). (detailing the history of the negotiations). Back To Text

[389] Tracht, supra note 378 at 608 n.18 (describing the "considerable debate" over this provision). Back To Text

[390] Id. at 641. We should approach the process of discussing what makes negotiation work with trepidation. Those studying the negotiation process have found it very difficult to defend a particular model of negotiation or renegotiation. "Economists have provided numerous game theory models from which to choose, and the primary conclusion that may be drawn is that results are highly sensitive to the particular assumptions on which any given model is built." Id. at 369 n.168 (citing e.g. Robert D. Cooter & Daniel L. Rubinfeld, Economic Analysis of Legal Disputes and Their Resolution, 27 J. Econ. Literature, 167, 178–80 (1989)). Back To Text

[391] See Tracht, supra note 378, at 640–41. Back To Text

[392] See 11 U.S.C § 362(d)(2)(B) (1994). Back To Text

[393] See J. Dennis Hynes, Lender Liability: The Dilemma of the Controlling Creditor, 58 Tenn. L. Rev. 635 (1991); see also A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285, 290 (Minn. 1981). An excellent series of commentaries appeared in the late 1980's dealing with the then–rising tide of lender–liability litigation. See, e.g., Helen Davis Chaitman, The Ten Commandments for Avoiding Lender Liability, 511 PLI/Comm 9 (1989); Helen Davis Chaitman, The Lender Strikes Back or How to Beat the Borrower at His Own Game, 551 PLI/Comm 91 (1990). Back To Text

[394] A recent Federal Reserve survey of senior bank loan officers suggested "another danger for the economy: risk–averse bankers could compound the economic slowdown by depriving borrowers of funds needed to expand or finance their businesses." Ip, supra note 377, at A2. Back To Text

[395] Indeed, this is one of the objectives of a securitization transaction. See supra notes 92–94 and accompanying discussion. Professor Mann's study, supra, note 52 included no sample of securitized transactions. Back To Text

[396] A source of evidence of such changes may come from examining moves to public funding sources. The recent report of Federal Reserve findings of tighter credit include the following anecdote:

In Massachusetts, tighter lending rules are driving more businesses to seek help from a state–government fund that acts as a lender of last resort to industrial concerns. Jonathan Raymond, president of the Corporation for Business, Work and Learning, the state–government fund says many recent applicants have had their long time banking relationships abruptly ended. "Suddenly they've had a bad quarter, two bad quarters, and it's like 'hey you're outta here,'" he says.

While some businesses are clearly in trouble, others have merely hit a rough patch and "need some hand–holding. But banks don't offer that kind of help anymore", Mr. Raymond said.

Ip, supra note 377, at A2–A6. Back To Text

[397] There is anecdotal evidence that the secondary loan market, which matured following the real estate–based recession of the early 1990's, will now be available to facilitate the desire of an institutional lender to move "bad assets" off its books and these resources are for the first time available on an industry–wide, institutional basis. Laura Mandaro, Preferred Issues: Secondary Loan Market to the Rescue?, at http://www.americanbanker.com (last visited Feb. 6, 2001) (quoting an analyst at Loan Pricing Corp. who commented that "the early 90s . . . secondary market," was mostly made up of "'people working credits out . . . . It was just some people getting together to trade loans,'" while "[w]hat's different today, said loan market observers, is the presence of a whole slew of entities besides banks that buy and sell syndicated credits, such as collateralized debt or loan obligations. There are also investors who focus wholly on acquiring distressed debt from originators like banks."). There is now a Loan Syndications and Trading Association (LSTA) which announced on August 2, 2000, an agreement with Standard & Poor's to create leverage loan indices that LSTA described as "a further sign of the 'coming of age' of the leveraged loan market." Standard & Poor's Credit Wire, S&P and LSTA to Create Leveraged Loan Indices – 1st Performance Benchmarks for the Loan Market, at http://www.pmdzone.com/news./index_.htm (visited Feb. 6, 2001) (quoting Allison Taylor, LSTA Executive Director). Back To Text

[398] Appended to Warren Memorandum, supra note 20. Back To Text

[399] The section number is from former Article 9. The comparable provision in revised Article 9 is § 9–323(b). Back To Text