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The Practical Lender

A bulletin devoted to highlighting the practical effects of law on the finance business. The  denotes practical lender tips for the lender.

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REVISED ARTICLE 9 (SECURED LENDING) OF THE UNIFORM COMMERCIAL CODE

An Overview of the Sweeping Revisions and How the Secured Lender Should Prepare

Revised Article 9 Sent to States for Adoption

After nearly a decade of drafting, the revised Article 9 of the UCC ("Revised Article 9"), has been approved by its drafting committee¹ and has been sent to all fifty (50) states for adoption.² Upon adoption, Revised Article 9, which has a *July 1, 2001* suggested effective date, will clarify, revise, update and in some instances reverse both the procedural and substantive rules which govern secured lending transactions.

The purpose of this article is to provide a brief summary of the planned revisions and provide practical suggestions which lenders in collateral-backed loans ("Secured Lenders"), should consider implementing in anticipation of Revised Article 9. Because many of these revisions relate to perfection issues, it is important to plan for them *now*, so that perfected security interests (and the underlying collateral) do not disappear upon final implementation of the new rules.³

Procedurally, Revised Article 9 is designed to simplify the filing process and enable the growth of "Electronic Commerce." Substantively, Revised Article 9 serves primarily to clarify the current secured lending rules with a few important exceptions.

Procedural Rules

Revised Article 9 strives to streamline and simplify secured transactions by revising the rules governing the

filing and execution of financing statements.



Under the new rules, financing statements must be filed in the Borrower's exact "legal" name and must be filed in the State where the Borrower is "located" (generally, this is the State where the Borrower was incorporated/formed).

Where and How to File. Revised Article 9 simplifies the filling of financing statements by: (1) adopting uniform national forms for financing statements;⁴ (2) permitting plain English, "super-generic" descriptions of the collateral (*i.e.* "all of the Borrower's assets") in financing statements;⁵ (3) eliminating "dual filing" at both the State and the County level for virtually all collateral, except real estate;⁶ and (4) most importantly, requiring filing *only* in the State where the Borrower is "located" (as opposed to multiple collateral locations).⁷

For purposes of Revised Article 9, "registered organizations" such as corporations and limited liability companies are located in the State in which they are organized. Unregistered entities, such as general partnerships, are located in the State where the "chief executive office" is located. Individuals are located in the State in which they reside.

Proper Name of the Debtor Clarified. Revised Article 9 also clarifies existing law, by overruling those courts which have held that filing against a trade name of the Borrower (even where that name is wholly unrelated to the Borrower's legal name, *i.e.*, Bob's Trucking, a d/b/a of ABC Corp.), is sufficient for filing purposes. The *only* proper name for filing purposes will be the Borrower's "legal name" (*i.e.*, for corporations and LLCs, the name which appears on their Articles of Incorporation/Formation).⁸

Electronic Commerce. Revised Article 9 anticipates the growth in "Electronic Commerce" by: (1) eliminating the need for signatures on financing statements; (2) requiring "authenticated documents" versus manually signed documents;⁹ and (3) requiring a "record" versus a

"writing."¹⁰ Revised Article 9 focuses on whether a filing is "authorized" versus signed. Consequently, the Secured Lender (if it has the Borrower's authorization), can file financing statements without the Borrower's signature.¹¹ Conversely, Borrowers can file termination statements without the Secured Lender's signature if the Secured Lender had a legal obligation to file a termination statement and failed to do so.

New Substantive Rules

Revised Article 9 builds on the current secured lending framework, and is designed primarily as a clarification of the existing rules. There are, however, a few important, substantive changes.

Scope of Article 9 Expanded. Revised Article 9 expands the scope of Article 9 to include several categories of collateral which previously were governed by non-UCC rules.¹² The inclusion of "Deposit Accounts" is perhaps the most significant expansion.¹³ In addition, Revised Article 9 expands the definition of "proceeds" of collateral to include not only items received upon "disposition" of collateral (such as monies received upon the sale of stock held as collateral) but also items received "on account of" that collateral (*i.e.*, dividends on stock). Revised Article 9 further expands the scope of the current Article 9 by prohibiting restrictions on the assignment of health care insurance receivables, promissory notes and certain general intangibles. Consequently, a Secured Lender taking a blanket lien under Revised Article 9 will be entitled to a broader range of collateral than under the current Article 9.



Secured Lenders will need to dramatically alter their procedures when perfecting liens against Deposit Accounts and/or Letters of Credit by entering into a "Control Agreement."

Method of Perfection. Revised Article 9 also makes several important changes concerning the method of perfecting a security interest. First, as to "Receivables," it grants a Secured Lender who has a perfected security interest in

Receivables an *automatic* perfected security interest in all "Supporting Obligations." "Supporting Obligations" are any letters of credit or guaranties which are issued as security for the underlying Receivable.¹⁴

Secondly, a security interest in "Instruments" (such as promissory notes), may be perfected by possession *or* filing. Consequently, a Secured Lender which perfects a security interest in "Instruments" solely by filing will be entitled to priority over lien creditors who do not have possession.¹⁵ Under current law, the Secured Lender must have actual physical possession of Instruments in order to be perfected.

Most importantly, Revised Article 9 adopts the concept of "Control Agreements" (which was introduced several years ago for Investment Property)¹⁶ and applies these rules to Deposit Accounts and Letters of Credit. A Control Agreement is an agreement between the Borrower, the Secured Lender and the party in possession of the collateral, granting the Secured Lender the right to control the disposition of the collateral.

Unlike with Investment Property, however, neither *possession* of the collateral, nor the *filing* of a financing statement against the Borrower's Deposit Accounts and/or Letters of Credit will serve to perfect the Secured Lender's security interest. Instead, a "Control Agreement" must be executed by the Secured Lender, the Borrower and the depository/issuing bank. Depository banks, however, are automatically perfected in their customers deposit accounts; *provided* a valid security interest exists.

For Letters of Credit this new control rule changes current law, which mandates possession of the Letter of Credit. Consequently, any Secured Lender which fails to enter into a Control Agreement concerning its Letter of Credit collateral will be transformed into an unsecured creditor upon implementation of the final Revised Article 9 rules.¹⁷

Other Changes. Although it is beyond the scope of this article, it should be noted that Revised Article 9 will: (1) adopt certain special "Consumer" rules; and (2) alter a number of rules pertaining to foreclosures, guarantor waivers and junior lender notices.

Preparing for Revised Article 9



By acting early, the practical Secured Lender can capitalize on the benefits provided by Revised Article 9 while avoiding many of the potential pitfalls caused by the transition. Some practical suggestions are set forth below.

1. *Where to File.* Under current Article 9, there is no need to file in the State of incorporation/formation if the Borrower has no assets or locations in that State (as is often the case with Delaware corporations). By requiring that a financing statement be filed in the Borrower's State of incorporation/formation for all new transactions and all amendments of existing transactions, a Secured Lender can reduce the possibility of losing its perfected status because it failed to "continue" its financing statement in the proper jurisdiction. Conversely, the Secured Lender should include the Borrower's State of incorporation/formation in its UCC searches.

2. *Name of the Borrower.* Under Revised Article 9, a financing statement will only be effective if a search of the exact legal name of the Borrower would reveal the filing. Therefore, the Secured Lender should confirm its practice of determining the exact "legal name" of the Borrower (as listed in its Articles of Incorporation/Formation), and filing against that name.

3. *Collateral Description.* Update all financing statement descriptions in blanket lien transactions to include a "super-generic" description in addition to the existing, exhaustive description (*i.e.*, "all assets of the Borrower now or hereafter acquired, including without limitation, [Insert Exhaustive Description]"). By doing so, a Secured Lender with a blanket lien can eliminate the argument, after the effective date of the Revised Article 9, that the description was inadequate or failed to cover a specific type of collateral. In addition, the Secured Lender should consider revising its Security Agreement to include the new categories of collateral included within the scope of Revised Article 9 (although these changes will not be effective until Revised Article 9 is implemented).

4. *Right to File Financing Statements*. All Security Agreements should be revised to include the right to file relevant financing statements *without* the Borrower's signature. This will eliminate the need for the Secured Lender, after Revised Article 9 takes effect, to get the Borrower's signature on amendments to the existing financing statements.

5. *Letters of Credit*. Secured Lenders should require a Control Agreement for all Letters of Credit which will remain in place after July 1, 2002.¹⁸

6. *Types of Collateral*. Revised Article 9 assumes that, absent a contrary intent, defined terms in Security Agreements executed prior to its effective date are limited to their previous Article 9 definitions. By including "as revised" language in all UCC definitions, the Secured Lender can ensure that its collateral includes the enlarged definition of such terms as "proceeds" when Revised Article 9 is implemented.

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Conclusion

The changes to policies and practices necessitated by Revised Article 9 are sweeping. Secured Lenders should develop consistent policy guidelines and procedures to more efficiently manage the transition process.

If you would like information about any finance topic, including further information on Revised Article 9, please contact the Vedder Price Finance and Transactions Group practice leader, [Michael Nemeroff](#) at (312) 609-7858 or mnemeroff@vedderprice.com, or any Vedder Price attorney with whom you have worked.

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Footnotes

¹Revisions to the UCC are promulgated by "NCCUSL," the National Conference of Commissions on Uniform State Laws.

[Return to Text of Article](#)

²It is anticipated that the vast majority of "commercial States," including Illinois and New York, will adopt the Revised Article 9 as of July 1, 2001.

[Return to Text of Article](#)

³Although Revised Article 9 has a suggested July 1, 2001 effective date, the transition rules provide that a perfected security interest under the old rules (which is not effective under the new rules) remains effective for a 1 year transition period. Properly filed financing statements, which serve to perfect security interests which can be perfected by filing under both the current Article 9 and Revised Article 9, remain effective even though the *place* of filing changes under Revised Article 9. Consequently, it will still be necessary to search all the States where the Borrower has collateral for five (5) years after Revised Article 9 becomes effective.

[Return to Text of Article](#)

⁴This assumes that Revised Article 9 is adopted by *all* fifty States without amendment of this provision.

[Return to Text of Article](#)

⁵Please note, these descriptions, by themselves, are not valid under the current Article 9. In addition, under Revised Article 9, a full description *must* still be given in the underlying Security Agreement.

[Return to Text of Article](#)

⁶A handful of States, including New York, still require dual filing of financing statements at both the State and County level. Given the loss of revenue involved for local county recorder offices, this provision is controversial and may not be uniformly implemented.

[Return to Text of Article](#)

⁷Under the current Article 9, Secured Lenders with blanket liens must file in every State where the Borrower has equipment or inventory and in the State where the Borrower's "chief executive office" is located. When combined with the dual filing rules, these provisions often

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require the filing of a dozen or more financing statements.

[Return to Text of Article](#)

⁸For unregistered entities, such as general partnerships, it may be difficult to determine the correct "legal name" of the entity. In these cases it is recommend that the Secured Lender file against both the purported partnership name and the names of each of the individual partners, where practicable.

[Return to Text of Article](#)

⁹Like similar provisions in other sections of the UCC, the use of the term "authenticated" documents, expands the UCC to govern both manually and "electronically" signed documents.

[Return to Text of Article](#)

¹⁰Similarly, a record includes both written documents and computer or other information that is stored in an "electronic or other medium."

[Return to Text of Article](#)

¹¹Generally, this consent would be memorialized in the Security Agreement, or in a Commitment Letter if the Secured Lender wished to pre-file its financing statements. Persons who file without the proper authority are subject to fines and penalties.

[Return to Text of Article](#)

¹²The scope of Revised Article 9 will be expanded to include deposit accounts, tort claims, health insurance, consignments, asset securitizations and governmental claims (which are not specifically excluded by statute).

[Return to Text of Article](#)

¹³Although Illinois and four other states already include Deposit Accounts within the current Article 9, the perfection rules governing this collateral will change. See *Method of Perfection* below.

[Return to Text of Article](#)

¹⁴Please note that a Secured Lender which is automatically perfected in a supporting Letter of Credit will be subordinate to a Secured Lender who later perfects through the use of a "Control Agreement." See the discussion of "Control Agreements" below.

[Return to Text of Article](#)

¹⁵Under the current Article 9, a Secured Lender must actually take possession of an Instrument to perfect its interest in it. It should be noted that under Revised Article 9, the Secured Lender who actually takes possession of an Instrument will have priority.

[Return to Text of Article](#)

¹⁶Revised Article 8 (Investment Property) allows the Secured Lender to perfect against stocks, bonds, etc., by filing a financing statement, taking possession of the securities (if they are properly endorsed), or entering into a "Control Agreement" with the party in possession of the collateral.

[Return to Text of Article](#)

¹⁷Unless, as stated above, the Letter of Credit was a "Support Obligation" and the Secured Lender had a perfected security interest in the underlying Receivable, in which case the Secured Lender would be automatically perfected (but would be junior to any Secured Lender which later entered into a Control Agreement).

[Return to Text of Article](#)

¹⁸Although Revised Article 9's suggested effective date is July 1, 2001, the drafters have provided for a 1 year transition period during which security interests perfected under the current Article 9 would remain valid even though they would not be effective under Revised Article 9.

[Return to Text of Article](#)

- ⌘ Return to: [The Practical Lender](#)
- ⌘ Return to the Vedder Price: [Publications Page](#).

⌂ [Return to: Top of Page.](#)

[Home](#) | [Legal Services](#) | [Attorneys](#) | **[Publications](#)** | [Recruiting](#) | [Seminars](#) | [Speakers](#) | [Alumni](#) | [Contact Us](#) |
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[Top of Page](#)

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