

The Practical Lender

Highlighting the practical effects of law on the finance business.

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REVISED ARTICLE 9 COMMON MISCONCEPTIONS

Revised Article 9 to the Uniform Commercial Code (“Revised Article 9”) went into effect in most jurisdictions on July 1, 2001 (the “Effective Date”) and in all jurisdictions as of January 1, 2002. Revised Article 9 had a primary intended purpose of streamlining secured transactions. In time, this goal will be met. However, in the short term, the transition to Revised Article 9 from Article 9 as it existed prior to the Effective Date (“Former Article 9”) has resulted in a number of misconceptions and some general confusion within the commercial lending community. This article addresses what we have seen as the most common misconceptions and provides practical advice in avoiding the pitfalls relating to such misconceptions.

Misconception: UCC lien searches need to be conducted only in the jurisdiction where the debtor is organized.

Guidance: After the Effective Date, a UCC financing statement filed in the jurisdiction of organization of a debtor that is a registered organization (e.g., a corporation, limited liability company or limited partnership) under state law is effective to perfect a security interest in such debtor’s assets in which a security interest may be perfected by filing. However, a search only in such debtor’s jurisdiction of organization is insufficient to determine if there are competing liens on the debtor’s assets.

In general, Former Article 9 required that a financing statement be filed where the collateral was located with respect to tangible collateral, such as inventory and equipment, and in the debtor’s place of business (or chief executive office if it had more than one place of business) with respect to intangible collateral, such as general

intangibles and accounts. Under Revised Article 9, a pre-Effective Date financing statement remains effective until the earlier of (i) its normal lapse under the law of the jurisdiction in which it is filed (the “Lapse Date”) or (ii) June 30, 2006. Therefore, regardless of the new rules requiring a financing statement to be filed in the debtor’s jurisdiction of organization, a pre-Effective Date financing statement filed in a jurisdiction other than the debtor’s jurisdiction of organization will remain effective until the earlier of the Lapse Date or June 30, 2006. UCC searches in all jurisdictions where a secured party would have filed a financing statement under Former Article 9 are therefore required until June 30, 2006.

Misconception: Unless an “in lieu” financing statement is filed or other action is taken within the one-year grace period beginning on the Effective Date and ending June 30, 2002 (the “Grace Period”), a pre-Effective Date financing statement will cease to be effective.

Guidance: An initial financing statement in lieu of a continuation statement (an “In Lieu Statement”) is required to continue a pre-Effective Date financing statement filed in a jurisdiction other than the jurisdiction required by Revised Article 9. The In Lieu Statement is filed in the jurisdiction required by Revised Article 9. In order to put subsequent searchers on notice that the In Lieu Statement is intended to continue the perfection and priority achieved by a pre-Effective Date financing statement (filed in a different jurisdiction than required by Former Article 9), the In Lieu Statement references the pre-Effective Date financing statement by filing office, date of filing and file number.

The Grace Period does not apply to a pre-Effective Date financing statement. As discussed above, a pre-Effective Date financing statement will remain effective until the earlier of its Lapse Date or June 30, 2006. An In Lieu Statement may be filed any time during the effectiveness of the pre-Effective Date financing statement. Thus, unless a pre-Effective Date financing statement happened to have a Lapse Date occurring during the Grace Period, no filing of an In Lieu Statement would be required during the Grace Period with respect to such pre-Effective Date financing statement.

Although not mandated by Revised Article 9, secured parties often deem it prudent to file an In Lieu Statement long before the Lapse Date of the pre-Effective Date financing statement. Some secured lenders file In Lieu Statements in connection with a review or an amendment of a particular credit to ensure they are taking full advantage of the benefits offered by Revised Article 9 and to ensure compliance with Revised Article 9. A complete Revised Article 9 review is also recommended with respect to all credits to make certain that the mandates of Revised Article 9 are satisfied.

Misconception: No action by the secured lender is required with respect to a security interest in collateral that is perfected prior to the Effective Date *other than by filing a financing statement.*

Guidance: Revised Article 9 provides that a security interest that is perfected *other than by filing a financing statement* immediately prior to the Effective Date, but with respect to which the Revised Article 9 requirements for perfection are not satisfied as of the Effective Date, will only remain effective for the Grace Period and will thereafter cease to be effective unless the secured party takes the steps necessary during the Grace Period to perfect the security interest under Revised Article 9. For example, prior to the Effective Date, a secured party could have perfected a security interest in instruments in the possession of a bailee by notifying the bailee of the secured party's security interest. However, under Revised Article 9, the bailee's receipt of such notification is insufficient for perfection. Now, the bailee's acknowledgement of the lender's security interest is required. Unless the secured lender obtains the bailee's acknowledgement

during the Grace Period (i.e., by June 30, 2002), the secured lender's perfection in the instrument will be lost. Thus, secured lenders must carefully analyze their security interests in collateral perfected other than by filing to determine whether any changes wrought by Revised Article 9 require their action during the Grace Period.

Misconception: A financing statement filed under Revised Article 9 will be effective so long as the debtor's name is "fairly close" to being correct.

Guidance: Getting the debtor's name "almost right" is not good enough. Under Former Article 9, case law provided some latitude when it came to naming the debtor. Revised Article 9 changed the rules and made it clear that the burden of correctly naming the debtor rests squarely upon the secured party. If a search of the records of the applicable filing office under the debtor's correct name using that filing office's standard search logic would not disclose the financing statement, the financing statement is seriously misleading and ineffective. How does the secured party ensure the debtor's name is correct? If the debtor is a registered organization (which will be the case in most commercial transactions), the debtor's name is determined by obtaining a certified copy of the debtor's organizational document from such debtor's state of organization.

It is worth noting that Revised Article 9 clarifies that a secured party need not file against any fictitious name(s) used by the debtor (i.e., trade name, d/b/a or other fictitious name other than the debtor's exact legal name). Due to conflicting case law under Former Article 9, some secured parties and their counsel felt it prudent to file against all fictitious names used by a debtor. Revised Article 9 specifies that the legal name alone is sufficient.

Misconception: The "organizational identification number" is the same as the tax identification number.

Guidance: Revised Article 9 requires the organizational identification number of all registered entities to be included on financing statements. The organizational identification number is a unique number assigned to a registered organization by its jurisdiction of organization. It is not the tax identification number (Federal Employer Identification Number or FEIN) as many debtors

otherwise believe. However, not all states are uniformly enforcing this requirement. Also, adding to the confusion is the fact that a few jurisdictions (e.g., New York) do not assign organizational identification numbers. In such cases, the applicable box on the financing statement should indicate that the debtor has no organizational identification number. In cases where the jurisdiction does assign an organizational identification number, it typically can be obtained from the charter documents, from a good standing certificate or directly from the registering office.

Misconception: If a secured party has filed a pre-Effective Date financing statement in the state of organization of a debtor that is a registered organization under state law, there is no need to file an In Lieu Statement.

Guidance: Even though a secured party may be perfected in the proper Revised Article 9 jurisdiction, this does not necessarily mean that an In Lieu Statement is not required. Recall that an In Lieu Statement is an initial financing statement filed in lieu of a continuation statement, and is required to continue the effectiveness of any pre-Effective Date financing statement filed in a jurisdiction other than the jurisdiction required by Revised Article 9. Therefore, if a secured party has filed pre-Effective Date financing statements in the debtor's jurisdiction of organization and in other jurisdictions in accordance with Former Article 9, an In Lieu Statement will be required to continue the effectiveness of the pre-Effective Date financing statements filed in the other jurisdictions.

The chart on page 4 clarifies the foregoing Guidance regarding the filing of In Lieu Statements. In each case, assume that the debtor is a registered organization organized under state law and that the secured party's security interest in the collateral covered by the pre-Effective Date financing statement(s) has attached and is perfected by filing under Former Article 9.

Misconception: Revised Article 9 took effect in all jurisdictions on the Effective Date.

Guidance: A few jurisdictions did not adopt Revised

Article 9 until after the Effective Date and/or delayed enactment of Revised Article 9 to a date later than the Effective Date. However, as of January 1, 2002, Revised Article 9 is in effect in all jurisdictions.¹

Since Revised Article 9 was not in effect in some jurisdictions during the period between the Effective Date and January 1, 2002, special care should have been taken with respect to transactions that closed and filings that were made during such period if those transactions/filings involved jurisdictions that delayed the Effective Date. If Revised Article 9 was not in effect in a particular jurisdiction at the time of filing, then the Former Article 9 rules must have been observed in order to be properly perfected. This means that if an initial financing statement was filed between the Effective Date and January 1, 2002 and the debtor maintained collateral in any of the jurisdictions that delayed the Effective Date, then a financing statement must have been filed in such state to perfect on the collateral located within that state, irrespective of the debtor's location (i.e., jurisdiction of organization for registered entities). Transactions that closed during this period should therefore be reviewed to determine if any collateral is at risk due to such collateral being located in a delayed Effective Date jurisdiction.

¹ Delaware, New York, Illinois and Michigan each adopted Revised Article 9 as of the Effective Date. Alabama, Connecticut, Florida and Mississippi each have delayed the effective date of Revised Article 9. If you have concerns about collateral located in a particular jurisdiction, please contact a Vedder Price attorney to determine if such jurisdiction had a delayed effective date of Revised Article 9.

SCENARIO	RESULT	IN LIEU STATEMENT FILING
Debtor's sole place of business and all of its assets are located in its jurisdiction of organization. Secured party has filed a pre-Effective Date financing statement in debtor's jurisdiction of organization.	Secured party is perfected and priority relates back to date of filing of the pre-Effective Date financing statement.	None required.
Debtor's sole place of business and all of its assets are located in jurisdiction(s) other than its jurisdiction of organization. Secured party has filed pre-Effective Date financing statements in such jurisdictions.	Secured party remains perfected in the collateral until the earlier of the Lapse Date of the pre-Effective Date financing statements or June 30, 2006.	Secured party should file an In Lieu Statement in the debtor's jurisdiction of organization; for priority purposes, the filing dates of the pre-Effective Date financing statements will control. The In Lieu Statement would need to be filed prior to the lapse of the pre-Effective Date financing statement(s) filed in the other jurisdictions.
Debtor's sole place of business is located in its jurisdiction of organization. Debtor has tangible assets located in jurisdictions other than its jurisdiction of organization. Secured party has filed pre-Effective Date financing statements in debtor's jurisdiction of organization and the other jurisdictions.	The pre-Effective Date financing statement filed in the debtor's jurisdiction of organization is sufficient to perfect in debtor's jurisdiction of organization when filed and in every other jurisdiction as of the Effective Date. However, in order to maintain the priority of the pre-Effective Date financing statements filed in the other jurisdictions, an In Lieu Statement must be filed in the debtor's jurisdiction of organization and such In Lieu Statement should reference the pre-Effective Date financing statements filed in the other jurisdictions in accordance with Revised Article 9.	Secured party should file an In Lieu Statement in the debtor's jurisdiction of organization. The In Lieu Statement would refer to each pre-Effective Date financing statement filed in jurisdictions other than the debtor's jurisdiction of organization. The In Lieu Statement would need to be filed prior to the lapse of the pre-Effective Date financing statement(s) filed in the other jurisdictions.

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