Overview of Current UCC Article 9

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Introduction. Many practitioners have asked why current Article 9 is now so much longer and more complex than former Article 9. The short answer is that some transactions formerly excluded by Article 9 have been brought within its scope, in the first place, and, in the second, current Article 9 resolves many issues not resolved by former Article 9. Therefore, if you read the comments, and the examples, there should be an answer to most of the obvious questions presented by the statute.

Before discussing the specific changes, let's look at some consequences for the practitioner.

a. The scope of Article 9 has been expanded. An obvious corollary is that there will be less collateral available for the unsecured creditor or for the creditor that did not successfully perfect its security interest. There's a greater premium on getting it right.

b. Another result is that some types of new original collateral held by one creditor may be proceeds of another creditor's collateral.

i. Deposit accounts are a new type of Article 9 collateral. A deposit account may contain the proceeds of the sale of inventory pledged to one creditor; it may also be pledged to another creditor as original collateral.

ii. Likewise, commercial tort claims are a new type of Article 9 collateral. They are included as original collateral but these may be the proceeds of the property that was destroyed by the tortious event (for example, inventory pledged to another creditor). Thus, it is likely that there will be even more priority contests under current Article 9 than former Article 9.

c. There may be more conflicts between security interests in new types of Article 9 collateral and statutory or common law liens (for example, current Article 9...
makes it possible to take a security interest in a commercial tort claim. However, this produces the possibility of a conflict between an attorney’s lien and the secured party’s interest in a commercial tort claim.

d. Some new categories of Article 9 collateral are non-filing collateral, that is, collateral that is either not perfected by filing or collateral that can be perfected by filing, but with respect to which perfection by filing will lose out in a priority contest to a security interest perfected in another manner. Some types of collateral are perfected automatically, that is, when the transaction takes place. Also, as before, some types of collateral are best perfected by possession. Alternative perfection methods, in turn, necessitates some new priority rules and introduces an additional layer of complexity into Article 9.

Let’s look at some examples.

1. Current Article 9 expands the definition of “account.”

   a. Former 9-106 reads: “Account” means any right to payment for goods sold or leased or services rendered ... whether or not it has been earned by performance.

   b. Current Article 9 “accounts” includes:

   - A right to payment for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of;
   - A right to payment for a secondary obligation (guaranty) incurred or to be incurred;
   - A right to payment for energy;
   - A right to payment for the hire of a vessel;
   - A right to payment arising out of a credit card;
   - A right to payment for lottery winnings; and
   - A right to payment under a health-care-insurance receivable.

   c. “Health-care-insurance receivable” means: an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided (9-102(a)(46)). The term “health-care” is not further defined and may apply to a wide range of treatments as long as insurance covers the treatment. In general, the party who is obligated on an account is an “account debtor,” but note that the rules that apply to account debtors do not apply to health-care insurers (Comment 5(a) to 9-102).
d. Note that many of the new types of "accounts" were formerly general intangibles or were excluded from the scope of Article 9. For example, insurance claims were always excluded, but now the insurance exclusion does not apply to the patient's assignment to the doctor of the health-care-insurance receivable or the doctor's assignment of the right to payment. The practical effect of shifting these into the "accounts" definition is that a financing statement must now be filed whether they are financed or sold, as current 9-109(a)(3) provides that Article 9 applies to the sale of accounts.

e. Another practical implication is that if you have an old security agreement which covers "accounts" but defines them with respect to "the U.C.C. as now in effect," that definition does not embrace the new definition of "account."

2. Article 9 now applies to sales of payment intangibles, defined as: a general intangible under which the account debtor's principal obligation is a monetary obligation (9-102(a)(61)).

a. The typical commercial loan is a "payment intangible".

b. The phrase "principal obligation" is intended to state that loan covenants which require the debtor to do other things in addition to making repayment do not place the transaction outside of the term "payment intangible."

c. Current Article 9 thus applies to assignments of loans in whole, as well as to sales of fractional undivided interests (loan participations) (9-109, comment 5).

d. Sales of promissory notes are also within the scope of current Article 9 (9-109(a)(3)).

e. As in former Article 9's treatment of sales of accounts, such coverage is not intended to characterize (or recharacterize) these transactions (or affect conclusions that these are true sales and not secured transactions); it is merely intended to deal with issues of perfection and priority. This is a drafting convention; very occasionally courts get it wrong. (See Comment 5 to 9-109, and P.E.B. Commentary No. 14.)

f. In order to conform to existing practice, sales of payment intangibles and promissory notes are perfected automatically – the purchaser need not file or take any other step to perfect (see 9-309(2)(3), and (4)).

3. Current Article 9 applies to true consignments (9-109(a)(4)). A consignment is a delivery of goods to a merchant for the purposes of sale (9-102(a)(20)). Sale or return provisions remain in Article 2. The consignment definition excludes:
a. goods delivered to a merchant who is generally known to be engaged in the
business of selling the goods of others;

b. small consignments (whose value is in the aggregate $1000 or less);

c. consignments of goods that are consumer goods immediately before delivery:

i. "Consumer goods" are: goods that are used or bought for use
primarily for personal, family, or household purposes (9-102(a)(23)).

ii. The predominant purpose controls. There will be hard cases when
an item, such as a computer, may be used both for business and
personal uses.

iii. The use may change; the test looks to the time period immediately
before delivery. For example, the computer is inventory when it is
delivered to a merchant such as Nobody Beats The Wiz; it then
becomes consumer goods as soon as it is purchased for personal,
family or household purposes (Comment 4(a) to 9-102) and
therefore if consigned is not within Article 9.

iv. The consumer goods definition has no dollar cap. Therefore, very
expensive consumer goods (such as a yacht or a Rolls-Royce
automobile) may be excluded from the definition of consignment.

4. One of the most important changes is the inclusion of deposit accounts as original
collateral.

a. These were excluded as original collateral under former 9-104(1).

b. It is not clear why deposit accounts were excluded. Comment 7 to former 9-
104 states cryptically: such transactions are often quite special, do not fit
easily under a general commercial statute and are adequately covered by
existing commercial law. One can only speculate that banks may have deemed
themselves adequately protected by the right of set-off.

c. As a result, under former Article 9 there was some uncertainty about
perfection under “other” (non-UCC) law. Was a simple three-party pledge
sufficient? Was it necessary to have the deposit account represented by an
“instrument” (such as a certificate of deposit) which is subject to Article 9,
and if so, was a nontransferable certificate of deposit inadequate?

d. Coverage of deposit accounts as original collateral (rather than as proceeds)
was originally regarded with suspicion by many Drafting Committee
members. In particular, there was concern that banks might require all
persons opening accounts to pledge them, even if the depositor did not intend to borrow from the bank, and that banks might hide such language in the fine print of opening account documentation that few persons read. As a result, the term does not include an “assignment of a deposit account in a consumer transaction.” Note that this does not mean that a consumer’s deposit account cannot be assigned in a commercial transaction.

e. Also, to allay concerns of depository banks, and to encourage them to permit third parties to acquire security interests in the accounts of their customers, the perfection and priority rules ensure that the depository bank will always trump the third party unless the third party establishes an account in its name with the depository bank. This could be done by having the debtor be an authorized signatory on the secured party’s account. If the secured party wishes to do so, it can revoke the signing authority, and thus exercise control over the account.

f. Regulators and others expressed concerns that the payment system be unaffected by the use of deposit accounts as original collateral, and that any transferee of funds from the deposit account be protected. Thus, the rule is that: a transferee of funds from a deposit account takes the funds free of a security interest in the depository account unless the transferee acts in collusion with the debtor in violating the rights of the secured party (9-332(b); compare revised Article 8).

g. Banks are protected by 9-342, stating that a bank is not required to enter into an agreement permitting its customer’s account to become another party’s original collateral, even if requested to do so, and that it need not confirm the existence of such an agreement unless requested by the customer to do so. Because banks are not required to furnish such information, the person taking a deposit account as original collateral is dependent upon the debtor’s statement that the account has not been pledged to another party. Because a bank may incur liability by volunteering this information and giving incorrect information, a bank will probably decline to provide information unless it is in its interest in a particular transaction to do so.

h. There is no Article 9 liability if a bank permits two assignments of the same account.

5. Commercial tort claims are now also included in the scope of Article 9. A “commercial tort claim” is: a claim arising in tort with respect to which: (A) the claimant is an organization; (B) the claimant is an individual and the claim: (i) arose in the course of the claimant’s business or profession; and (ii) does not include damages arising out of personal injury to or the death of an individual (9-102(a)(13)).

a. The after-acquired property clause does not include commercial tort claims because these claims were not relied upon in making the loan (9-204(b)(2)).
b. Like deposit accounts, there was some debate among Drafting Committee members about whether there was a need for this provision. One use would be to finance the expenses of litigation, such as expert witnesses, court stenographers and transcripts, etc.

c. There will be a conflict in some cases between the attorney's lien and the interest of the secured party. A court might reason that the secured party acquires only the interest that the client has to give, so that if the lawyer is owed 1/3 of the recovery when the secured party acquires its interest, the security interest is limited to the remaining 2/3. It is in the interest of the secured party and the lawyer to enter into an intercreditor agreement.

6. Documents presented under a letter of credit; letters of credit and other support obligations; letter-of-credit rights.

a. Under new section 5-118, the issuer has a security interest in certain documents presented under a letter of credit (including written documents other than a document of title or an instrument).

i. A security agreement is not necessary.

ii. If written documents are presented, the security interest is perfected and has priority over a conflicting security interest as long as the debtor does not have possession of the document.

b. For other types of documents presented under a letter of credit, see 9-313 (a secured party may perfect in negotiable documents and instruments by taking possession.)

b. Under 9-203(f), if a security interest has attached in collateral, a security interest has also attached in a "supporting obligation" for that collateral. Thus, if a security interest has attached in a payment intangible, it has also attached in a support obligation for that collateral.

i. This rule makes express what many would have assumed: that a support obligation is an incident of the collateral it supports.

ii. Under 9-102(a)(77), a letter of credit or a guarantee is clearly a supporting obligation.

iii. A put, make-whole agreement, repurchase agreement, or suretyship contract may be a supporting obligation as well. Comment 5(f) to 9-102 states that a policy of insurance, although generally excluded from Article 9, may be a supporting obligation for purposes of this rule.
c. A letter-of-credit right is a new type of Article 9 collateral. Under 9-102(a)(51), a letter-of-credit right is: a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. There are some significant limitations:

i. The secured party does not have the right to draw. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit (9-102(a)(51)).

ii. The secured party’s interest is perfected by “control” of the letter-of-credit right. This is a concept borrowed from Article 9’s treatment of investment property. However, whereas one acquires “control” of investment property by entering into an agreement with the party holding the investment property, one acquires “control” over the letter-of-credit right only by having the issuer consent to an assignment of proceeds as provided in Article 5 (9-107). The issuer is not required to consent (revised 5-114(c)).

iii. The transferee’s rights are independent of and superior to the rights of the secured party (revised 5-114(e)).

7. Investment property. Under 9-102(a)(49), investment property means: a security, whether certificated or uncertificated [i.e., whether or not in book-entry form], security entitlement, securities account, commodity contract, or commodity account.

   a. Issues relating to perfection in securities, security entitlements, and securities accounts are governed by Articles 8 and 9, in conjunction with each other.

   b. Issues relating to commodity accounts and commodity contracts are resolved by Article 9 and other law (Comment 6 to 9-102).

8. Treatment of “non-assignable” assets.

   a. Article 9-406(d) governs security interests in accounts, chattel paper, payment intangibles, and promissory notes (other than sales of payment intangibles and promissory notes).

   b. It provides that prohibitions, restrictions, and consent requirements in the underlying agreement or instrument are void.

   c. It provides also that terms in the underlying agreement or instrument making the assignment or enforcement of the security interest an act of default or a breach of the agreement are likewise void.
d. The uniform version of current Article 9 contains an additional provision
overriding governmental statutes, regulations, and other rules of law
prohibiting assignment of accounts or chattel paper.

e. New York did not enact this rule, therefore, in New York it is still necessary
to be aware of these restrictions. The most important of these statutes are
collected in the New York Law Revision Commission Report in the
discussion under this section. Among the most significant are:

i. Governmental contracts;

ii. Lottery winnings;

iii. Restriction on the assignment of a claim (the champerty statute), which
may affect security interests in commercial tort claims.

g. Article 9-408 contains parallel provisions governing sales of payment
intangibles and promissory notes and assignments of health-care-insurance
receivables and certain general intangibles, including permits, contracts,
licenses, and franchises.

h. Likewise, New York did not enact the override of statutes, rules and
regulations prohibiting such assignment. There is likewise a list
(comprehensive, but not necessarily complete) in the Law Revision
Commission Report. In general, if there is a government regulated license, the
practitioner should search for a restriction on transfer.

i. The transfer of a health-care-insurance receivable or a permit, contract,
license, or franchise does not impose any additional duties on the account
debtor.

9. As many of you probably are aware, there have been multiple changes intended to
simplify the filing system.

a. There is a national form of financing statement.

b. The debtor's signature is no longer required; the debtor need only authorize
the filing.

c. A financing statement may be filed on "all assets." (The security agreement
must be more specific.)

d. Local filing is, for most purposes, abolished.

e. The filing is made in the jurisdiction where the debtor is organized, if it is
a "registered organization."
f. The debtor may file a correction statement (9-518) or termination statement (9-509(d)(2) after the debtor has demanded that the secured party do so. This is taken from a provision of New York law that permits such mortgage terminations if the mortgagee fails to do so.

g. Some financing statements have extended lives, beyond five years. These are:

i. Public-finance transactions;

ii. Manufactured home transactions; and,

iii. Cooperative apartment filings (in N.Y.)

10. Current Article 9 expands consumer protections. These will be discussed in detail later on today. These provisions should be important even to those of you who ordinarily think of yourselves as commercial lawyers, since there is no dollar cap on the concept of a consumer transaction. Thus, a yacht, a jet, or an art collection can qualify if it is used primarily for personal, family, or household purposes.

   a. This would require foreclosure in accordance with the consumer rules.

   b. There is a saving provision that permits the secured party to rely on the debtor’s statement that a transaction is not a consumer transaction (9-628(c)).

11. Current Article 9 provides for electronic chattel paper (9-105).

   a. Perfection is by control over the electronic chattel paper.

   b. Article 9 sets forth certain technological requirements which, if satisfied, by the system, satisfy the requirement of control.

   c. The statute does not require, but does contemplate, a third-party custodian. The parties cannot simply agree that the requirements have been met and thus circumvent the technological requirements in the statute.

   c. These technological requirements are similar to those that exist in statutes outside of Article 9 for that enable one to become a holder of a mortgage note under E-Sign or of a note or document of title under the Electronic Transactions Act (“UETA”)(Sec. 16). These are called “transferable records.”

   d. None of these statutes provide what happens if the system, advertised as one that meets the technological requirements, later proves vulnerable to a hacker, so that the system requirements were not in fact met.
i. One possibility is that a court would rule that there was never electronic chattel paper, or a transferable record, since the system requirements were not met.

ii. Perhaps a court would conclude that the secured person holds something similar, such as an assignable contract right.