1-1-2002

A Glance at the New Article 9 Secured Transaction

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www.nmbar.org New Mexico Bar Journal 21

Those of us who teach a course on Article 9 of the Uniform Commercial Code (Secured Transactions) dreaded the approach of July 1, 2001. On that day, a revised version of Article 9 became effective in New Mexico[1] and most other states.[2] The old notes had to be discarded. New materials had to be prepared, or at least the old ones had to be revised. Perhaps there would be some excitement in learning what the drafters had done, but more obvious was the effort needed to learn something new. Maybe it was time to retire.[3] We have now taught the revised version of Article 9.[4] We know a little more about it now, and perhaps by next year, we'll know more.

Introduction Revision of Article 9 began in 1990. The new version was first promulgated after the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Law (NCCUSL) approved it during the summer of 1998. The revision is part of an overall review of the entire Uniform Commercial Code which was originally drafted in the late 1940s. It follows substantial revisions of Article 3 (Negotiable Instruments), Article 4 (Bank Deposits and Collections), Article 5 (Letters of Credit) and Article 8 (Investment Securities).[5] Over the past several years, New Mexico has adopted all of the revisions and, accepting the recommendations of the ALI and the NCCUSL, has repealed Article 6 (Bulk Transfers). A casual glance at the revised Article 9 supported our original trepidation. The number of definitions in the definitions section has increased from 14 to 80. However a good part of the increase results from moving definitions found throughout the prior version of Article 9 to that section. The number of sections, however, has increased from 57 to 135, suggesting that the revised version is somewhat more detailed and perhaps more complex. Thankfully, the theory and concepts of Article 9 have not changed. There is one device for security interests in personal property — the security interest. If a creditor has a security interest, the creditor has a right to possession of the goods upon

the debtor's default, and the further right to sell the property and to use the proceeds to satisfy the debt. Among other things, Article 9 governs the creation of the security interest, the rights and duties of the secured party and the debtor, and the rights of the secured party against third parties who claim an interest in the goods, i.e., purchasers from the debtor, other secured parties and those who have judicial or statutory liens on the goods.

Creation and Perfection of Security Interests One purpose of the revision was to recognize the emerging use of the Internet to conclude deals. Creation of a security interest under the prior version required a signed writing. Under the revised version, there must be an authenticated record. Since "record" includes a computer file, and "authentication" includes a symbol or an encryption, security interests can be created over the Internet. To protect its rights against third parties, the secured party usually must "perfect" its security interest. Although in some cases the secured party may perfect by taking possession or control of the collateral, and in a few cases perfection is automatic, the most common way to perfect is by filing a financing statement. The revised Article 9 simplifies filing by establishing central filing for financing statements in New Mexico, and in all other states, except when the collateral is fixtures, timber to be cut or collateral that is to be extracted. [6] Also, since the document filed to record a security interest (a "financing statement") need no longer be signed, Article 9 facilitates the adoption of Internet filing.[7] Filing is also greatly simplified when a secured party must determine the correct state in which to file in a multistate transaction. Under the prior version, the law tended to look to the place where the collateral was located, and required the secured party to "chase" the collateral as it moved. In the revised version, the location of the debtor, not the collateral, controls. However, in communities that are near the state line it may be difficult to determine where the debtor is located when he or she has homes in more than one state. Also, the name of the debtor may be difficult to determine if the debtor, such as a married women, uses two names. Will the name that appears on a driver's license? These problems existed under the pre-1999 version, but the methods of searching suggested for use under the revised version seem to make the answers to these difficult questions more important.[9] To achieve uniformity, Revised Article 9 contains a form financing statement. Although a few states have tinkered with it a little, the result will be that a search in any state will disclose the same information. And what about searching? Electronic searching for filings is possible in most states, including New Mexico.[10] In making searches, it is essential that the correct and full name be entered in the appropriate space. For example, in many, if not most, states, including New Mexico, a search for the word "Turtle" will not disclose any filing for "Turtle Construction." A new method of perfection, applicable only to investment property, deposit accounts, letter of credit rights and electronic chattel paper is by the secured party taking control of the collateral. What constitutes "control" of the collateral depends upon the type of the collateral. For example, control of a deposit account can be obtained by having the bank agree in an authenticated record that it will comply with instruction of the secured party

without further consent by the debtor.

Additional Types of Property Available as Collateral Revised Article 9 has reclassified the types of property in which a security interest may be given and has expanded the scope of the Article by including some types of property that could not be collateral under the pre-1999 version. There is no change in the basic classification of goods: under Article 9 they are equipment, inventory, farm produces and consumer goods. However, for some purposes, manufactured homes and "as extracted collateral"[12] are treated separately,[13] hence, in effect, there are two new categories of goods. As to intangibles, there have been many changes — some of them only in terminology. For example, the definition of "accounts" has been significantly expanded and much collateral that formerly was characterized as "general intangibles" are now accounts. The primary importance is that *sales* of what were previously general intangibles, but which are now accounts, are now within Article 9. Thus, a financing statement must now be filed to protect the secured party from others who claim an interest in the obligation. Article 9's scope is now broader, due to the inclusion in the Article of new types of collateral. Prior to the revision, a sale of negotiable instruments was not covered by Article 9, now it is. Previously, a creditor could not take a security interest in deposit accounts, now the secured party can. Unlike the pre- 1999 version, the creditor could not take a security interest in any tort claims. Now, "Commercial Torts" may be subject to a security interest. New types of collateral now defined by the Code include "payment intangibles," "software," "letter of credit rights," "supporting obligation," "healthcare- receivables" and "promissory notes." Chattel paper now comes in two flavors: "tangible chattel paper" and "electronic chattel paper."[14] The creation of agricultural liens is left to other border of the states surrounding New Mexico it may not always be easy to determine the location of debtors who have ties to both New Mexico and the other state when the debtor is an individual, partnership or unincorporated association. Thus, while the secured party is no longer required to find and "chase" the collateral, it now needs to correctly locate the debtor. Locating the debtor under the revised Article 9 is counterintuitive, at least at first. For example, a registered organization, i.e., a corporation, limited liability company or a limited partnership, is located in the state in which it is registered. Thus, when the debtor is a corporation organized under Delaware law, the financing statement must be filed in Delaware even if the corporation does business only in New Mexico. Again, the location of the collateral is no longer important, since the secured party files where the debtor is located. The requirement that the debtor's name be correctly stated on the financing statement was important under the pre-1999 version of Article 9. It is even more important under the revised version, because any error in stating the debtor's name is deemed to be "seriously misleading," making the filing ineffective.[15] In class we ask such questions as what name should be inserted as a first name when the debtor's birth certificate lists his name as John Thomas Wipperwill, but he always uses the name "J. Thomas Wipperwill" and is universally known by that name? What about a woman who, after her marriage, sometimes still uses her maiden name but at other

times uses her married name? Is it sufficient to use the but their priority as to Article 9 security interests is governed by the revised Article. Additionally, all consignments are now within the scope of the Article. The finer distinctions made in defining collateral allowed the drafters to provide narrow rules governing each type. For example, revised Article 9 provides that a sale of a promissory note, which, as noted above, is now within the scope of Article 9, is perfected automatically, but a holder in due course takes free of the rights of the secured party.

Priorities The changes made in the rules determining who has priority, a secured party or another party who both claim interests in the same collateral, are so minor that they are hardly worth mentioning. New sections govern the priority of agricultural liens and consignees, but with few exceptions, the rights of the secured party against purchasers of the collateral, other secured parties, judicial lien creditors, and statutory lien credits remain the same.

Secured Party's Rights Against the Debtor

The secured party's right to repossess the goods upon default and then sell them — and in some cases keep them in satisfaction of the debt — has not been significantly altered by Revised Article 9. Since agricultural liens are now enforced as though they were Article 9 security interests, a provision was needed to determine when the debtor is in default on credit secured by an agricultural lien. When the collateral is enforced by self-help, whether there has been a breach of the peace has been the subject of much litigation, although not in New Mexico. Revised Article 9 does not attempt to clarify when a breach of the peace occurs, however, leaving this interesting factual question up to the courts. New Article 9 includes forms for giving notice of an Article 9 sale, which provides a safe harbor for those giving the notice. When the sale brings more or less than the amount of the debt, consumer debtors are given some protection, through a provision requiring an explanation of how the deficiency or surplus was calculated. The New Mexico rule, that when the secured party fails to follow the procedures on notice and sale of the collateral, there is a presumption that the damages to the debtor equal the amount of any deficiency, has been specifically adopted for transactions where the debtor is not a consumer.

Conclusion When it was drafted more than 50 years ago, Article 9 was the most innovative of the UCC Articles. Perhaps the most striking observation from the revision process is that the original Article 9 has stood the test of time. While revising it after a half century was clearly in order, the changes are not as major as they first appear. The changes in detail are significant, but the core concepts remain. We are just beginning to be comfortable with the changes. In another few years we will understand it better and it probably won't be long before we forget the pre-1999 version. Despite the tinkering in the practical details of the Code, the theoretical questions surrounding secured credit remain largely the same. During the past decade or so, numerous law review articles have debated the question of whether secured credit is beneficial to the economy. A central question in these articles — written mostly by those who believe in an economic approach to the law — is whether secured credit lowers the overall cost of credit. Clearly, those who take a security interest can afford to charge less for the credit advanced because they have a

greater chance of being paid if the debtor gets into financial trouble. But what about those who, because of business practices, supply unsecured credit? Is the cost of that credit higher as a result of their subordinate position? And if it is, is the overall cost of credit for businesses higher? One thing is clear at least to us; not every creditor who lends on an unsecured basis has consciously *chosen* not to take a security interest. Many cannot get one. Nor is it clear that these unsecured creditors can then *choose* to charge a higher interest rate because they are not secured. This cause and effect seems missing and thus, these questions about the effect of secured credit on the cost of credit remain unanswered. A second question recently explored is whether the advantages given to secured creditors over general creditors, are fair. For example, is it fair that some of the supplier's of Furr's supermarket get little or nothing even though during the final days of the business they made it possible for Furr's to continue? And what about the employees of Furr's? And there is the question of involuntary creditor, for example one who had a negligence claim against a Furr's? One scholar has even suggested that an involuntary tort claimant, who may not have even chosen to do business with Furr's, should actually get a higher priority in the bankruptcy of such a company than the secured creditors.[15] This is obviously not reality, as the secured creditor in today's economy often takes all in a bankruptcy. Furr's is no exception. Because virtually all of the assets of Furr's were encumbered by security interests, unsecured creditors stand little chance of recovery. This can only be considered *fair* if you believe that unsecured creditors made the actual *choice* to be unsecured. Regardless of one's position in these debates, it is clear that the secured creditors won the battle in the drafting of Revised Article 9. It is now possible to take security interests in more types of property, and it is easier for the secured party to protect its interest (by perfection) against general creditors and trustees in bankruptcy. Consumers, you and we who buy goods for our household purposes, may have gained a tiny bit, but not much in the revision process. Almost all of the changes supported by consumer groups were discarded in the final draft. In the final analysis, it is clear that the revised version has many features that will clarify the law of secured transaction. But, it must be said that the revision is a banker's bill

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Endnotes *[1] Laws 2001, Ch. 139. Codified as Section 555-9-101 et. Seq. NMSA 1978 [2] All states adopted Article 9 prior to July of 2001, but three states delayed the effective date until later in 2001. [3] Of course this is true only of Fred who claims to be on the shady side of the mountain. Nathalie disagrees and finds him younger than she is in many ways, including his desire to learn new things. [4] Nathalie has taught it twice, Fred delayed as long as he could and has only taught it once, and that time was with Nathalie. He is going to try it on his own next year. [5] A revision of Article 1 was approved by the ALI and the NCCUSL in 2002, but has not been adopted by any state at the time this*

is being written. Revision of Article 2 has been "completed" but still has not been offered to the states because it still has some controversial provisions. A re-revision of Articles 3, 4 and a revision of Article 7 are in the works. [6] *In the past, some states required two separate filings in certain situations and more categories of collateral had to be filed locally rather than in the statewide system. Nathalie's home state of Pennsylvania, for example was one of the so called "dual filing" states, which meant that the secured party had to file both in the Secretary of State's probably the law under the pre-1999 but the revised version is specific. The only exception is when a search under the debtor's correct name would disclose the filing. Section 55-9-506(c) NMSA 1978. This is highly unlikely in New Mexico and many states.* See *text at n. 5,* infra. [9] *Since it is now contemplated that most searches will be done electronically and by name, and because the test for "seriously misleading" is whether the competent searcher would find the financing statement in a typical search, literal precision is now required.* [10] *http://www.sos.state.nm.us/UCC/UCCHOME.HTM* [11] *Section 55-9-104(a) NMSA. 1978. The debtor, however, need not give up the right to draw on the account. Section 55-9-104(b) NMSA 1978.* [12] *"As extracted collateral" is oil, gas or other minerals to which a security interest is to attach when they are extracted from the ground and accounts arising out of the sale at the wellhead of oil, gas or other minerals.* [13] *For example, a financing statement has a 30-year life for a manufactured home whereas for most other types of collateral it is five years.* See *Section 55-9-515(b) NMSA.* [14] *The definitions of these and other types of collateral are found in Section 55-9-102.*
[15] See *Lynn Lopucki*, The Unsecured Creditor's Bargain, *80 VA. L. REV. 1887, 1909 (1994).*

Office and the local filing system, for any borrower with only one office in the state. Now only one filing is required. Moreover, in all the states, security interests in consumer goods had to be filed locally, but now they are filed in the statewide system, like most other collateral. [7] *Only a few states, including Delaware, presently allow filing electronically. New Mexico does not, but it is likely that it will be possible in New Mexico in the not too distant future.* [8] *Section 55-9-506(b) NMSA 1978. This was*