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Conclusion

With all of its limitations stated above, plus others, the Article 9 and its revisions are palatable in comparison to other options. After all, Article 9 does provide the framework for the basic solution even if the answer is required elsewhere – e.g., bankruptcies, IP, real property, and service contracts.

The position that the attraction of the UCC Article 9 process, as compared with its potential replacements and the threshold issue, is the importance of uniformity. This does not address reality, for there is no reason to think that legislators in North Dakota would happen upon the same set of rules governing secured transactions as would legislators in New York.

Regulatory competition is thus not likely to create a uniform system of laws with a better consistent outcome as Article 9.

While Article 9 undoubtedly has not addressed every conceivable situation, it has addressed many. New federal law is likely to have more unaddressed problems. For example, federal law currently governs security interests in intellectual property. All agree that those laws answer far fewer questions than does Article 9. It is reasonable to suppose that were the federal government to assert primary responsibility for crafting a law of secured transactions for a limited set of cases, this law would be less complete than current Article 9. While the observation that certain groups are underrepresented in the Article 9 drafting process is correct. The better solution to this problem is to have the federal government act on a targeted basis against the background of this law rather than to cede primary responsibility for secured transactions to Congress.

To be sure, Article 9 may be better than its predecessors in terms of its ease of use, but it is by no means the best that can be done.

Where is the Ideal Solution for the "Next Article 9" Coming From?

Possible Providers	Realistic Challenges	Probability
Congress	Not going to happen. Cannot envision how Congress would undertake a process curtailing major secured credit lobbyist's interest. However, a nationally (or commonly) utilized database of the perfected assets would be of value.	Very Low
States	Interstate Commerce requires a cohesive timing and agenda (although not necessarily fully unformed) .	Low
UCC Commission	The last such undertaking took years and the results were "moderate" at best.	Low
Federal Courts	Unfortunately, this has been the direction of many of the complex challenges with IP. A challenge is timeliness. One-off specialized solutions that may not be applicable across the board for modern – let alone – future technologies.	Moderate
No Change	Despite the fact that the majority of assets may be covered outside the purview of Article 9 – IP, Real Property, international issues - the present process albeit, complicated and antiquated – serves a valid foundation. This foundation is supplemented by other authoritative sources.	High

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UCC Article 9
What is it? What Are its Challenges?

Written by: Michael R. Koeppel

Addressing the challenges of UCC Article 9 is not for inexperienced players. It is paramount that you work with an attorney who has experience in this field. This article/presentation is meant to outline the general parameters and the author's specific comments. It is not meant to serve as legal advice.

General Comments

The Uniform Commercial Code (UCC) has proven to be the standardized solution to accommodate the vast commercialized growth in the US for decades, with Article 9 addressing the secured interest of lenders. Its self-stated goal of uniformity has achieved remarkable results.

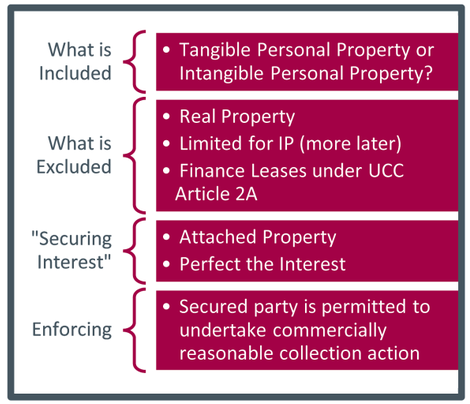
As turnaround professionals, we consistently confront Article 9 issues. Article 9 enables lenders to take a security interest in collateral (i.e. the assets of debtors); thereby, the law of secured transactions provides lenders with assurance of legal relief in cases of default by the borrower. The proponents of Article 9 contend that the availability of such remedies encourages lenders to offer lower interest rates, facilitating the free flow of credit and stimulating economic growth.

Article 9 is not without its challenges and opponents. Before addressing its challenges though, let's outline Article 9 and its processes.

Article 9 – What is it?

Article 9, Secured Transactions, may be the most significant of the UCC's eleven substantive articles. It provides the rules governing any transaction (other than a finance lease) that combine a debt with a creditor's interest in a debtor's personal property. If the debtor defaults, the creditor may repossess and sell the property (generally called collateral) to satisfy the debt.

For the debtor to generate a "secured interest" in the collateral, two steps are required: "attachment" and "perfection."



Attachment

Attachment generally occurs when the security interest is effective between the creditor and the debtor, and that usually happens when their agreement provides that it's taking place. Attachment requires that:

- the debtor have rights in the collateral or the power to convey rights;
- the value be given; and
- in most cases, a security agreement, authenticated by the debtor, adequately describing the collateral.

By itself, attachment of a security interest does not ensure that the secured party's interest in the collateral will be superior to the interest of other lienors or subsequent buyers, lessees, or licensee. In general, to obtain priority over such other claimants, the security interest must be "perfected." Although, some security interests are perfected automatically upon attachment.

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Perfection

Perfection occurs when the creditor establishes his or her "priority" in relation to other creditors of the debtor in the same collateral. It refers to letting the state know that you have said interest in place on the specific assets—a notice function. Every secured creditor has a priority over an unsecured creditor.

There are at least four methods of perfecting security interests in assets under the UCC. These include:

- filing financing statements (UCC-1 Form);
- by possession;
- by control; and
- by other methods under state and federal law, which involves the filing of certificates of title or other legal compliance (e.g., motor vehicles, airplanes and boats).

The somewhat unpretentious description in the prior paragraphs should not mislead anyone. Article 9 is not simple. There are substantial exceptions to the above-stated perfection rule. Priority is also not always a matter of perfecting a security interest first in time. This discussion is beyond the scope of this article.

Default and Enforcement

The creditor with "priority" may use the collateral to satisfy the debtor's obligation when the debtor defaults before other creditors subsequent in priority may do so. Generally, the first to file has the first priority, and so on.

Summary of the Revised Article 9

UCC Article 9 was substantially revised in 1998 and adopted in all states. The 2010 Amendments to UCC Article 9 modify the existing statute to respond to filing issues and address other matters that have arisen in practice following a decade of experience with the 1998 version of UCC Article 9.

Of most importance, the 2010 Amendments provide:

- guidance as to the naming conventions;
- improve the filing system;
- extraneous information will no longer be required;
- greater protection for an existing secured party having a security interest in after-acquired property when its debtor relocates to another state or merges with another entity;
- a secured party is obliged to notify a secondary obligor when there is a default;
- junior secured creditors and lienholders who have filed financing statements, must be notified when a secured party repossesses collateral; and
- if a secured party sells collateral at a low price to an insider buyer, the price that the goods should have obtained in a commercially reasonable sale, rather than the actual price, is the price that will be used in calculating the deficiency.

Challenges of Article 9

The success of the UCC, both in terms of its substance and its widespread adoption is a monumental tribute to our uniform commercialization through the country. Nevertheless, Article 9, including its revisions is not without its short-comings. In the author's perspective, several of these shortcomings are much more serious than others. The debates over Article 9 have been extensive and wide ranging. The following is a summary of numerous Article 9 limitations sited.

Economic Efficiency

There are assertions that Article 9 encourages inefficient investment by allowing the debtor and the secured creditor to externalize costs onto non-adjusting unsecured creditors. Many economists, including myself, believe that this entire system creates a perverted incentive for certain investment organizations to take excessive risk. These investment organizations enjoy limited liability, but participate fully in the gains from any investment. In deciding whether or not to undertake an investment, the investment firm thus does not expect to bear the full cost of failure. Who does – the unsecured creditors? Voluntary creditors pick whom to deal with and on what terms; tort victims do not.

Provides Inefficient Priority Rights

In a somewhat different vein, prominent scholars argue that even if contractual priority produces a net benefit for society, this benefit could be generated without the current Article 9. Article 9 sets forth a system by which a debtor can, via contract, grant priority rights in its various assets to various lenders. Even if this institution of secured credit is efficient, it can be generated more easily. A simple rule of enforcing negative pledge clauses against third parties would work better. A negative pledge clause is lending agreement language designed to prevent borrowers from pledging the same collateral to multiple lenders or otherwise taking actions that might jeopardize the security of existing lenders.

To be sure, there is another way in which all persons, including consumers, can be affected by Article 9, specifically, Article 9's extant treatment of involuntary creditors. General state law treats involuntary creditors who have yet to record a judgment as unsecured creditors. Moreover, once an involuntary creditor records a judgment, her priority dates from that act. In a world of "first in time, first in right," the general upshot of this treatment is that involuntary creditors will take a back seat to any secured lender. A good bit of ink has been spilled in determining the ways in which this treatment is viewed as inefficient or unfair.

Representation of Creditors in the Process

The UCC is now viewed as the output of a private legislature. Like all legislatures, this legislature is comprised of individuals who have their own biases and goals. Moreover, the drafting process is susceptible to interest group pressures, which rather than producing the best law possible, may generate a law that serves the need of the interest group. The most obvious interest groups who attempt to affect the content of commercial law are those groups directly affected by the law in the applicable area – financial institutions / banks. Of course, banks themselves are not necessarily a homogenous lot. Any overlap between the public interest and the UCC is one of circumstance, not inevitability.

Neither recent revision of Article 9 added any value to unsecured creditors – it actually curtailed their already limited options.

Intellectual Property

Intellectual property rights are a multifarious, atypical and evolving importance in today's commercial environment. As a result, commercial lending institutions have become more interested in securing obligations of prospective corporate borrowers with their intellectual property such as patents, trademarks and copyrights. The question arises as to how to properly perfect a security interest in intellectual property. Recall that intellectual properties fall under the purview of the USPTO ("United States Patent Trademark Office") – a federal agency.

Perfecting a security interest against competing claims to the collateral usually requires the secured party to give public notice by effectuating a filing in a government office. However, when the secured collateral is intellectual property, should commercial lenders use the filing system mandated by the state, typically based on a version of the UCC, the federal filing systems for patents, trademarks and copyrights, or both? And if both are required – is it inevitable that discrepancies will exist?

Yet the federal courts have reverted to the "pre-technology" days of 1879 for guidance. The Federal Circuit, quoting an 1879 case, Hendrie v. Sayles, 98 U.S. 546, indicated that the application of the bona fide purchaser defense is a matter of federal law. Thus, the best method for perfecting a security interest in patents is to file a UCC-1 financing statement with the state, to protect that security interest against future lien creditors, and to record the security interest in the USPTO, to protect the claim against subsequent purchasers or mortgagees for value.

Is Uniformity Required - UCC

There is a need for uniformity in the goods context that does not exist in other areas of the entire mantra of the UCC's uniformity. My contention is that the UCC addresses at best a minority subset of "commercial property." Notably missing from Article 9 are security interests in land, which are governed by state law, and in patents and copyrights, which are governed by federal law (refer to above). This lack of completeness ensures that Article 9 will not cover a bulk of financing transactions. Real estate transactions, at least in terms of dollar amounts, currently dominate asset-based finance, and the importance of intellectual property rights as collateral is geometrically increasing. Some areas of commercial law, notably land contracts, service contracts, and real estate mortgages, remain non-uniform. Are these areas of law suffering?

UCC Article 9 – Silent to Bankruptcy

Bankruptcy law also is generally considered part of commercial practice, but it cannot be found in the UCC. To be sure, any bankruptcy case will likely involve UCC issues. Contracts for goods may create either claims or assets for the debtor, and lenders with personal property as collateral need perfected security interests as required by Article 9 if they want a secured claim. However, the substance of bankruptcy law is in the Bankruptcy Code, not the Uniform Commercial Code. All of the areas not covered by the UCC, are covered by some other law. It is not as if there is no law for contracts regarding services or pledges of real estate.

Recordation System Optimal

The potential for problems with a non-uniform state-by-state recordation system is readily apparent. Consider a debtor incorporated in one state, the laws of which bases recordation on state of incorporation, but which has assets in another state, the laws of which bases recordation on the location of assets. Whether these concerns motivated states or not, the actual results are that all states quickly adopted the new article on secured transactions. A filing system that no one can find is of little value. With real estate, the answer of where to look is relatively easy. The location of the land is fixed, and the searcher merely has to learn at which level, state or local, the records are kept. Things are not so simple, however, when the assets at issue are movable, or even intangible, property.

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