

## **UCC Recent Developments: Practical Implications for Lenders' Security Interests**

Best Practices to Protect Client Confidences and Advertise Legal Services

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THURSDAY, DECEMBER 20, 2012

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Today's faculty features:

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# UCC Recent Developments

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# Introduction

- Effect of the UCC on the transfer and enforcement of real estate notes
- Treatment of LLPs under Article 9 choice of law rules
- Effect of anti-assignment terms on security interests in partnership and LLP interests
- Recent case law
- 2010 Amendments to Article 9

# PEB Report on mortgage notes

- Issues covered by the PEB Report
- PETE issues
- Creation of rights in the mortgage
- Mortgage follows the note
- Foreclosure on mortgage if not record owner of mortgage

# Related issues

- Comparable rules where Article 3 does not apply
- Agency law
- Real estate law



# Scope of PEB Report

- What the Report covers
- What the Report does not cover

# PETE

- Applies only to ‘negotiable’ notes (UCC Article 3)
- Usually, PETE is ‘holder’ of note
  - Possession
  - Note indorsed to person in possession or indorsed or in blank

# Creation of effective right in the note

- Applies to negotiable and non-negotiable instruments (Article 9)
  - Applies to sales and security interest to secure an obligation
- Requires:
  - Value
  - Transferor has ‘rights’ or ‘power’ to transfer rights in the note
  - Security agreement
    - Authenticated, or
    - Other security agreement plus possession

# Mortgage follows the not

- Applies to negotiable and non-negotiable instruments (Article 9)
  - Applies to sales and security interest to secure an obligation
- Follows real estate law in general
  - Applies to deeds of trust
- ‘Automatic’ attachment (UCC § 9-203(g))
- ‘Automatic’ perfection (UCC § 9-308(e))

# Enforcement without assignment of mortgage

- Assignment of mortgage not necessary to create or perfect a security interest in underlying mortgage
- Secured party may record instrument in real estate records to facilitate enforcement of mortgage if necessary on default of mortgagor
- Clarifying amendment in 2010 amendments to Article 9

# PETE for non-negotiable notes

- Article 3 does not apply
- Some rules in common law of contracts apply
  - May vary by state
- Some rules in UCC Article 9 apply

# HDC

- Secured party (whether buyer or lender) may also qualify as Article 3 holder in due course (negotiable instruments only)
- HDC requirements:
  - Possession by secured party
  - Indorsement to secured party or in blank
  - Secured party gives value
  - Secured party in good faith
  - No notice of claim to instrument or defenses

# Real estate law

- UCC rules apply to the extent relevant to real estate law
  - *E.g.*, real estate law may turn on who ‘owns’ the note and the mortgage
- Real estate law provides other rules
  - *E.g.*, procedures for foreclosure



# Agency law

- UCC generally recognizes use of agency law (UCC § 1-103(b))
- UCC Articles 3 and 9 repeatedly refer to application of agency law
- Restatement (Third) of Agency refers to application of agency law to UCC issues
- Particularly relevant where questions of secured party's 'possession' matter

# PEB Report on LLPs and Article 9 ‘location’ rules

- General rule for ‘organizations’
- General rule for ‘registered organizations’
- Treatment of partnership as ‘organization’

# Status of LLP as ‘general partnership’

- LLP not formed or organized by filing of public organic record
- LLP therefore an ‘organization’ but not a ‘registered organization’

# Assignment of LLP and Partnership interests

- 9-406 and 9-408's application to interests in unincorporated business organizations
- Transfers restrictions on interests in limited liability company and partnership interests
  - Arising by contract
  - Arising by statute
- Policy tension between financing rights to payment vs. “pick your partner” principle
  - DE and other states enacting non-uniform provisions to exempt out interests in unincorporated business organizations
- Reason for PEB commentary
- Status of commentary

# Terminology

- Agreement
- Economic rights
- Governance rights
- Owner
- Ownership interest
- Transfer
- Transfer restriction

# Scope of §§ 9-406 and 9-408

- Characterization
  - Is the interest “investment property”?
    - Opt-in available under 8-103(c)
    - If opt-in, 9-406 and 9-408 do not apply at all
  - Is the interest a “payment intangible”?
    - Economic rights
  - Is the interest a “general intangible” which is not a payment intangible?
    - Entire interest, i.e., economic rights plus governance rights

# Scope of §§ 9-406 and 9-408

- Transaction
  - Is the transaction a security interest that secures an obligation?
    - § 9-406 applies if the collateral is a payment intangible
    - § 9-408 applies if the collateral is a general intangible that is not a payment intangible
  - Is the transaction a sale of economic rights
    - § 9-408 applies to a sale of a payment intangible
  - Is the interest a sale of “general intangible” which is not a payment intangible?
    - Article 9 does not apply at all

# Scope of §§ 9-406 and 9-408

- Transaction
  - Is the transaction a gift?
    - Article 9 does not apply at all
  - Is the transaction a transfer by operation of law?
    - Article 9 does not apply at all



# Account debtor

- §§ 9-406 and 9-408 override a transfer restriction between the debtor and the account debtor
- Who is the account debtor?
  - The company/partnership
  - But not the other owners

# § 9-406

- Applies to a security interest that secures an obligation if the collateral is a payment intangible
  - SP is granted a security interest in Debtor's economic rights in Debtor's LLC interest to secure a loan
  - Contractual transfer restriction is overridden with respect to the LLC
    - 2010 amendments clarification
  - Contractual transfer restriction is not overridden with respect to the other owners
  - Legal restriction not overridden
    - 9-406(f) does not apply to a payment intangible

# § 9-408 -security interest securing an obligation

- Applies to a security interest that secures an obligation if the collateral is a general intangible that is not a payment intangible
  - SP is granted a security interest in Debtor's entire LLC interest to secure a loan
  - Contractual and legal transfer restrictions are overridden with respect to the LLC *short of enforcement*
    - LLC is not required to recognize SP
  - Contractual and legal transfer restriction are not overridden with respect to the other owners

# § 9-408 -sale of a payment intangible

- Applies to a security interest that is a sale of a payment intangible
  - Debtor sells Debtor's economic interest in an LLC interest to Buyer
  - Contractual and legal transfer restrictions are overridden with respect to the LLC *short of enforcement*
    - LLC is not required to recognize Buyer
  - Contractual and legal transfer restrictions are not overridden with respect to the other owners

# Recent decisions

- Issues presented
- Transactional suggestions to deal with the cases

# Drafting, Negotiating, Strategy

- *In re Milller*, 2012 WL 3589426 (C.D. Ill. 2012)
- *In re Green*, \_\_\_\_ B.R. \_\_\_\_ (Bkrtcy. N.M. 2012)
- Get the debtor's name right on the financing statement

# Collateral description

- *In re Michelle R Brown*, 2012 WL 4208777 (Bkrtcy. D. Kan. 2012)
- *Monticello Banking Company v. Flener*, Lexis 132300 (6<sup>th</sup> Cir. 2011)
- Describe your collateral accurately
  - Security agreement
  - Financing statement

# Commercial tort claims

- *In re American Cartage, Inc.*,  
656 F3rd 82 (1<sup>st</sup> Circ. 2011)
- Describe those commercial tort claims in the security agreement



# Federal preemption

- *In re Tracy Broadcasting* 2012 WL 4874485 (10<sup>th</sup> Cir. 2012)
- Beware of federal preemption

# Foreign collateral

- *Danka & Hackett v. Del Monte*, 228 Ariz. 533, 269 P.3d 709 (App. 2012) (review denied May 31, 2012).
- Don't forget the foreign collateral

# 2010 Amendments to Article 9

- Status of state enactments
- Effect if not all states are effective on July 1, 2013
  - Massachusetts Business Trusts
    - Possible change in ‘location’

# New filing forms

**UCC FINANCING STATEMENT**  
 FOLLOW INSTRUCTIONS

A. NAME & PHONE OF CONTACT AT FILER (optional)

B. E-MAIL CONTACT AT FILER (optional)

C. SEND ACKNOWLEDGMENT TO: (Name and Address)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S NAME: Provide only 222 Debtor name (1a or 1b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the individual Debtor's name will not fit in line 1a, leave all of item 1 blank, check here  and provide the individual Debtor information in item 1c of the Financing Statement Addendum (Form UCC1A).

1a. ORGANIZATION'S NAME

OR

1b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
1c. MAILING ADDRESS	CITY	STATE	POSTAL CODE COUNTRY

2. DEBTOR'S NAME: Provide only 222 Debtor name (2a or 2b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the individual Debtor's name will not fit in line 2a, leave all of item 2 blank, check here  and provide the individual Debtor information in item 2c of the Financing Statement Addendum (Form UCC1A).

2a. ORGANIZATION'S NAME

OR

2b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
2c. MAILING ADDRESS	CITY	STATE	POSTAL CODE COUNTRY

3. SECURED PARTY'S NAME (or NAME of ASSIGNEE of ASSIGNOR (SECURED PARTY): Provide only 222 Secured Party name (3a or 3b).

3a. ORGANIZATION'S NAME

OR

3b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
3c. MAILING ADDRESS	CITY	STATE	POSTAL CODE COUNTRY

4. COLLATERAL: This financing statement covers the following collateral:

5. Check 222 if applicable and check 222 one box: Collateral is  held in a Trust (see UCC1A item 17 and instructions)  being administered by a Decedent's Personal Representative

6a. Check 222 if applicable and check 222 one box:  Public Finance Transactions  Manufacturing/Leasing Transaction  A Debtor is a Transferee UCC  Agriculture Lien  Non-UCC Filing

7. ALTERNATIVE DESIGNATION (if assigned):  Lender/Lessor  Collateral Controller  Seller/Buyer  Bailee/Bailor  Licensee/Licensee

8. OPTIONAL FILER REFERENCE DATA:

UCC FINANCING STATEMENT (Form UCC1) (Rev. 04/2011)

# Transition rules

- UCC §§ 9-801 et seq.
- Proposed effective date July 1, 2013
- Things to do:
  - Update individual names
  - Update trust names
  - Reconsider business trusts
  - Watch for new forms

# UCC Recent Developments

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