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Revisions to Article 9 draft

MEMORANDUM TO: Executive Committee of the National Conference of
Commissioners on Uniform State Laws

FROM: Steven L. Harris and Charles W. Mooney, Jr.

DATE: June 9, 1999

RE: Proposed Revisions of Official Text of Uniform Commercial Code
Article 9

CC: Standby Committee for Revised UCC Article 9

This memorandum contains four proposals for changes to the Official Text of Revised Article 9. The Standby Committee for UCC Article 9 recommends the first three proposals, which for the most part correct inadvertent errors in the Official Text. The last proposal, Proposal 4, addresses certain needless inconsistencies. The Standby Committee contemplates that the proposed revisions will be accompanied by appropriate changes to the Official Comments.

PROPOSAL 1—INDICATION OF COLLATERAL IN FINANCING STATEMENT

Proposal: The Standby Committee proposes the following change to § 9-504:

SECTION 9-504. INDICATION OF COLLATERAL. A financing statement sufficiently indicates the collateral that it covers ~~only~~ if the financing statement provides:

- (1) a description of the collateral pursuant to Section 9-108; or
- (2) an indication that the financing statement covers all assets or all personal

property.

Explanation: Revised Article 9 has changed the requirements for indicating collateral in a financing statement. This change was inadvertent. There is lots of learning under former Article 9 to the effect that particular words that are insufficient as a "description" for purposes of a security agreement because they do not "reasonably identify" the collateral (e.g., "machinery") may nevertheless suffice as an "indication" of collateral and satisfy the notice function of a financing statement. Under revised §§ 9-108 and 9-504, the only difference between the description requirement for a security agreement and the indication requirement for a financing statement is that an "all assets" indication is good for the latter but not the former. This means that an indication (other than an "all assets" indication) of collateral in a financing statement would be insufficient unless it would suffice as a description in a security agreement.

The revised Official Comment would make clear that (i) § 9-504 is a safe harbor, (ii) indications that are neither descriptions nor "all assets" indications are sufficient if they satisfy the statutory purpose of a financing statement, and (iii) § 9-504 is not intended to render ineffective an indication that would have been effective under former Article 9.

PROPOSAL 2—PRIORITY OF FUTURE ADVANCES VS. LIEN CREDITOR

Proposal: The Standby Committee proposes the following changes to §§ 9-317 and 9-323:

SECTION 9-317. INTERESTS THAT TAKE PRIORITY OVER OR TAKE FREE OF UNPERFECTED SECURITY INTEREST OR AGRICULTURAL LIEN.

(a) **Conflicting security interests and rights of lien creditors.]** ~~A An~~ unperfected security interest or agricultural lien is subordinate to the rights of:

- (1) a person entitled to priority under Section 9-322; and
- (2) except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time the security interest or agricultural lien is perfected or a financing statement covering the collateral is filed.

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SECTION 9-323. FUTURE ADVANCES.

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(b) **[Lien creditor.]** Except as otherwise provided in subsection (c), a security interest is subordinate to the rights of a person that becomes a lien creditor ~~while the security interest is perfected only~~ to the extent that it the security interest secures advances an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:

- (1) without knowledge of the lien; or
- (2) pursuant to a commitment entered into without knowledge of the lien.

* * *

Explanation: Sections 9-317(a)(1) and 9-323(b) need adjustment to deal properly with the following scenario. Assume SP files a financing statement on 4/1 but does not give value

until 4/15. Lien creditor (LC) levies on 4/7. SP (with knowledge of the lien and no commitment to make advances) makes an additional advance on 6/15.

The intended result is that the additional advance is subordinate to the rights of the lien creditor. However, § 9-323(b) by its terms does not apply. LC is not a "person that becomes a lien creditor while the security interest is perfected." The security interest was not perfected until 4/15, when SP gave value and its security interest attached. LC became a lien creditor on 4/7—after the financing statement was filed but before the security interest was perfected.

Section 9-317(a)(2) doesn't quite work on these facts either. It refers to the rights of a person holding an unperfected security interest. In the example, SP never held an unperfected security interest. The security interest became perfected simultaneously with attachment.

In addition to conforming to the revised text, the revised Official Comments would make clear that § 9-323(b) does not elevate the priority of a security interest that would be subordinate to a lien creditor under § 9-317.

PROPOSAL 3—DEFINITION OF "CHATTEL PAPER"

Proposal: The Standby Committee proposes the following changes to § 9-102:

SECTION 9-102. DEFINITIONS AND INDEX OF DEFINITIONS.

(a) [Article 9 definitions.] In this article:

* * *

(11) "Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, or a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include charters or other contracts involving the use or hire of a vessel. If a transaction is evidenced both by records that include a security agreement or lease and by an instrument or series of instruments, the group of records taken together constitutes chattel paper.

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Explanation: The definition of "chattel paper" would be revised to accommodate the practice of "leasing" goods and accompanying software. This practice is analogous to purchase-money financing of goods and software, in which the security interest is eligible for special purchase-money priority. The draft approved at the 1998 NCCUSL annual meeting was intended to reach this result; however, the statutory formulation contained an error and was deleted.

In addition, the revised definition would not limit "chattel paper" to records evidencing transactions in which the secured financier or lessor takes a security interest in a license of software used in the goods or itself is the licensor of the software. Nor would it limit "chattel paper" to transactions in which the monetary obligation evidenced by the records is secured by the goods or software or is under a lease of the goods or license of the software. Instead, the revised definition also would include transactions in which the debtor's or lessee's monetary obligation includes amounts advanced by the secured party or lessor that enable the debtor or lessee to acquire a license of the software used in the goods. It would not be necessary that the monetary obligation actually be owed under a license from the secured party or lessor or that the secured party or lessor actually be a party to the license transaction itself.

Thus, with respect to financing the receivable at the next tier, the revised definition would treat in the same manner (i) security-interest-cum-license paper, (ii) lease-cum-license paper, and (iii) security interest or lease paper in which the monetary obligation includes repayment of advances used by the debtor to acquire the software.

PROPOSAL 4—MISCELLANEOUS

Issue: The following changes will eliminate needless inconsistencies in the Official Text:

SECTION 9-210. REQUEST FOR ACCOUNTING; REQUEST REGARDING LIST OF COLLATERAL OR STATEMENT OF ACCOUNT.

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(d) [Request regarding list of collateral; no interest claimed.] A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and claimed an interest in the collateral at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

- (1) disclaiming any interest in the collateral; and
- (2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's security interest in the collateral.

SECTION 9-406. DISCHARGE OF ACCOUNT DEBTOR; NOTIFICATION OF ASSIGNMENT; IDENTIFICATION AND PROOF OF ASSIGNMENT; RESTRICTIONS ON ASSIGNMENT OF ACCOUNTS, CHATTEL PAPER, PAYMENT INTANGIBLES, AND PROMISSORY NOTES INEFFECTIVE.

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(d) **[Term restricting assignment generally ineffective.]** Except as otherwise provided in subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

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(f) **[Legal restrictions on assignment generally ineffective.]** Except as otherwise provided in Sections 2A-303 and 9-407 and subject to subsections (h) and (i), a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(1) prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of

recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

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SECTION 9-407. RESTRICTIONS ON CREATION OR ENFORCEMENT OF SECURITY INTEREST IN LEASEHOLD INTEREST OR IN LESSOR'S RESIDUAL INTEREST.

(a) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (b), a term in a lease agreement is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of a party to the lease to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease.

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SECTION 9-408. RESTRICTIONS ON ASSIGNMENT OF PROMISSORY NOTES, HEALTH-CARE-INSURANCE RECEIVABLES, AND CERTAIN GENERAL INTANGIBLES INEFFECTIVE.

(a) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (b), a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the

promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

* * *

(c) [Legal restrictions on assignment generally ineffective.] A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

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SECTION 9-409. RESTRICTIONS ON ASSIGNMENT OF LETTER-OF-CREDIT RIGHTS INEFFECTIVE.

(a) [Term or law restricting assignment generally ineffective.] A term in a letter of credit or a rule of law, statute, regulation, custom, or practice applicable to the letter of credit which prohibits, restricts, or requires the consent of an applicant, issuer, or nominated