

# Clients & Friends Memo

## **New York Enacts Revisions to the UCC**

**December 29, 2014**

As many readers are aware, substantial revisions to Article 9 of the Uniform Commercial Code (the “UCC”) became effective in all 50 states and the District of Columbia in 2001 or shortly thereafter.<sup>1</sup> Although these amendments modernized and simplified commercial law and practice in important respects, enough ambiguities and frictions arose between theory and practice to justify statutory fine tuning. Accordingly, the Uniform Law Commission and the American Law Institute set to work on amendments in 2008. A version of these amendments were signed into law in New York by Governor Cuomo on December 17, 2014. They are part of an omnibus bill that, in addition to amending Article 9, updates several other articles of New York’s version of the UCC (hereafter referred to as the “Act”).<sup>2</sup>

The stated purpose of the Act is to make commercial transactions more predictable and to bring New York law into accord with the law in effect in other states.<sup>3</sup>

This memo first discusses the most salient revisions to Article 9 and then briefly describes certain revisions to Articles 1 and 7.

### **Article 9**

#### **Debtor Name**

The notice filing system lies at the bedrock of Article 9. As financing statements are indexed by debtor name, using the correct debtor name on the financing statement is the key to perfection. In particular, a financing statement is effective only if it “provides the name of the debtor.”<sup>4</sup>

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<sup>1</sup> Revised Article 9. (with conforming amendments to Articles 1, 2, 2A, 4, 5, 6, 7, and 8).

<sup>2</sup> See A9933 AN ACT to amend the uniform commercial code, in relation to modernizing commercial law in New York state; and to repeal certain provisions of such code relating thereto.

<sup>3</sup> Nevertheless, revised Articles 3 and 4 of the UCC have not yet been enacted in New York.

<sup>4</sup> UCC § 9-502(a)(1) (2001). Section references are to the New York UCC amended by the Act. Unless otherwise indicated, section references to the 2001 version of the UCC and the amended version are identical.

The UCC includes a safe harbor under which a financing statement is effective notwithstanding minor errors or omissions so long as such errors or omissions are not seriously misleading.<sup>5</sup> Errors and omissions are not seriously misleading if a search under the “debtor’s correct name,” using the “filing office’s standard search logic,” would disclose the financing statement notwithstanding the errors or omissions.<sup>6</sup> However, the UCC does not define “search logic,” and search logics are not uniform across jurisdictions. As a result, this safe harbor may or may not save the day for a secured party which misapprehends, or misuses, the debtor’s name.

### Individual Debtors

A major source of litigation under the UCC<sup>7</sup> revolves around the surprisingly elusive question of what is the “correct name” of an individual debtor for purposes of a financing statement. The 2001 version of the UCC provides, somewhat tautologically, that “[a] financing statement sufficiently provides the name of a debtor ... only if it provides the ... name of the debtor.”<sup>8</sup> Importantly, this rule does not clarify whether a nickname is sufficient or whether the failure to include a middle name or initial will render a financing statement ineffective.

Consider an individual debtor known as Harry Truman. Is the correct first name of such debtor “Harrison” or “Harry”? Does the debtor have a middle name? If the individual claims that his full and correct middle name is “S” (*i.e.*, period omitted), would a financing statement filed against “Harry S. Truman” (*i.e.*, period included) be ineffective? Further, what is the source of an individual debtor’s name: a birth certificate, passport, driver’s license, Social Security card or all (or none) of the above?

The Act includes a new individual name rule that will reduce transaction costs and litigation risk by removing, or at least decreasing, legal uncertainty in this area.

Specifically, if the debtor is an individual to whom the State of New York has issued a driver’s license or non-driver photo identification card that has not expired, the name of the individual as shown on the driver’s license or non-driver photo identification card must be used on the financing statement. If an individual debtor does not have such a driver’s license or identification card, the

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<sup>5</sup> UCC § 9-506(a) (2001).

<sup>6</sup> UCC § 9-506(c) (2001).

<sup>7</sup> See, e.g., *Hopkins v. NMTC Inc. (In re Fuell)*, 2007 Bankr. LEXIS 4261 (Bankr. D. Idaho 2007) (“Andrew Fuel” insufficient where debtor’s name is “Andrew R. Fuell”); *Pankratz Implement Co. v. Citizens Nat’l Bank*, 130 P.3d 57 (Kan. 2006) (financing statement filed against “Roger House” ineffective where debtor’s name is “Rodger House”); *Morris v. Snap-On Credit, LLC (In re Jones)*, 2006 WL 3590097 (Bankr. D. Kan. 2006) (“Chris Jones” insufficient where debtor’s name is “Christopher Gary Jones”); and *Clarke v. Deere & Co. (In re Kinderknecht)*, 308 B.R. 71 (B.A.P. 10th Cir. 2004) (financing statement filed against “Terry J. Kinderknecht” ineffective where debtor’s name is “Terrance Joseph Kinderknecht”).

<sup>8</sup> UCC § 9-503(a)(4)(A) (2001).

financing statement must indicate (1) the debtor's "individual name" (which term is not defined and essentially represents a default to the rule under the 2001 UCC) or (2) the debtor's surname and first personal name.<sup>9</sup>

The principal virtues of this approach are simplicity and certainty. The secured party will only need to identify one name when filing and searching. On the other hand, reliance on a driver's license or ID card is not a panacea. For example, a driver's license or ID card may expire, or the holder may have it issued in another name.

Also, not all potential individual debtor name issues are addressed.. Consider, for example, the problem that arises when the debtor's name derives from a language using characters that can be transliterated in different ways (e.g., is the correct name "Mao Tse Tung" or "Mao Zedong"?). Prudent creditors will be constrained to continue searching and filing under multiple names.

### **Registered Entity Debtors**

The UCC provides concrete guidance regarding the correct name of a debtor that is a "registered organization," such as a corporation, limited partnership or limited liability company. Nevertheless, doubt has arisen about the exact source for determining such correct name. Under the 2001 UCC, the "correct name" of a registered entity is "the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized."<sup>10</sup> The problems are, first, determining what constitutes the "public record" and, second, determining which record controls when there is more than one such record.

The Act addresses both points. First, it creates a new definition: "public organic record," which means "a record initially filed with or issued by a state or the United States to form or organize an organization."<sup>11</sup> This definition excludes other public records or indexes maintained by jurisdictions, such as good standing certificates or indexes of domestic corporate entities.

The Act also establishes rules for determining which "public organic record" controls. If there is more than one such record, the most recently filed record controls, and when there are multiple name references within the applicable record, the reference that is identified as indicating the name of the debtor controls.<sup>12</sup>

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<sup>9</sup> UCC §§ 9-503(a)(4)-(5) (amended).

<sup>10</sup> UCC § 9-503(a)(1) (2001).

<sup>11</sup> UCC § 9-102(a)(68) (amended).

<sup>12</sup> UCC § 9-503(a)(1) (amended).

The Act also adds a new sentence to the definition of “registered organization,”<sup>13</sup> to make it clear that statutory trusts are included in the definition: “The term [*i.e.*, ‘registered organization’] includes a business trust that is formed or organized under the laws of a single state if a statute of the state governing business trusts requires that the business trust’s organic record be filed with the state.”

This clarification is consistent with market expectations under the 2001 UCC.

### **Control**

The Act includes two new methods by which a secured party can obtain control over a deposit account, and thus perfect a security interest in, a deposit account. First, the secured party will have control if the deposit account is in the name of the secured party or if the name of the deposit account indicates that the secured party has a security interest therein.<sup>14</sup>

Also, the secured party will have control over a deposit account if another person has control on behalf of the secured party.<sup>15</sup>

Finally, the Act clarifies that a secured party has control over a securities account or a deposit account even if the obligation of the securities intermediary or bank to comply with entitlement orders or instructions, as the case may be, is subject to conditions (as long as the condition is not the further consent by the debtor).<sup>16</sup>

### **Automatic Perfection in Lottery Winnings**

Section 9-309 provides for the perfection upon attachment, “automatic perfection,” of certain specified transfers. The Act expands the scope of this rule by providing for automatic perfection in the case of the “sale by an individual of an individual of an account that is a right to payment of winnings in a lottery or other game of chance.”<sup>17</sup>

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<sup>13</sup> UCC § 9-102(a)(71) (amended).

<sup>14</sup> UCC § 9-104(a)(4) (amended).

<sup>15</sup> UCC § 9-104(a)(5) (amended).

<sup>16</sup> UCC §§ 8-106(i), 9-104(d) (amended).

<sup>17</sup> UCC § 9-309(14) (amended).

### Article 1

In a nutshell, Article 1 is an “umbrella” article that states rules of general applicability to transactions governed by the UCC.

The Act repeals the prior version of Article 1, although many of the changes are not substantive. The more significant “provisions include the following:

- The Act clarifies that Article 1 applies to a transaction only to the extent it is governed by another article of the UCC.<sup>18</sup>
- The Act also clarifies the circumstances in which other bodies of law supplement, or are displaced by, the UCC.<sup>19</sup>
- The Act retains the so-called “good heart/empty head” standard of good faith, which only requires “honesty in fact.”<sup>20</sup>

### Article 7

Article 7 governs documents of title, which are records, such as bills of lading and warehouse receipts, that evidence the right to goods in transit or storage. These documents have traditionally been issued in paper format.

Reflecting the ongoing “dematerialization” of commerce and finance, the Act introduces a category of document termed “electronic document.” Conforming amendments to Article 9 provide that perfection in an electronic document can be achieved by control.<sup>21</sup> The Act includes a general test to establish “control,” under which a “person has control . . . if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.”<sup>22</sup>

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<sup>18</sup> UCC § 1-102 (amended).

<sup>19</sup> UCC § 1-103(b) (amended).

<sup>20</sup> UCC § 1-201(b)(20) (amended).

The uniform version adopts a more objective approach by also requiring “the observance of reasonable commercial standards of fair dealing.”

<sup>21</sup> UCC § 9-314(a) (amended).

<sup>22</sup> UCC § 7-106(a) (amended).

The Act also enumerates a more specific list of criteria which, if satisfied, will establish control.<sup>23</sup>

**Transition Provision**

The Act [went into effect on December 17, 2014 and applies to transactions entered into on such date or thereafter.<sup>24</sup>

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If you have any questions concerning the Act, please feel free to contact any of the following Cadwalader attorneys.

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<sup>23</sup> UCC § 7-106(b) (amended).

<sup>24</sup> Note that this transition rule contrasts with the transition rules under the version of the amended UCC promulgated by the Uniform Law Commission and the American Law Institute. The provisions of the latter generally apply retroactively, subject to several grandfather clauses.