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Brave New World: Protocol After Article 9 Transition Period

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Opinion

It has been a long road through the transition period and into the era of revised Article 9 of the Uniform Commercial Code (UCC). Understanding of, and compliance with, the transitional rules has been of great importance, since failure to comply resulted in the loss of perfection or priority of existing security interests. Banks and the professionals who represent them, however, will be happy to know that the rules (as outlined herein) they must follow under revised Article 9 are, in some ways, simpler and safer.

Revised Article 9, which made several changes to the methods of perfection under the existing Article 9 of the UCC, was adopted in all 50 states. Revised Article 9 became effective in 46 states and the District of Columbia on July 1, 2001, in Connecticut on Oct. 1, 2001 and in the remaining states by Jan. 1, 2002. Consistent with the scope and detail of revised Article 9, section 9-701 of the UCC provides a detailed set of transitional rules governing the transition from the old Article 9 to revised Article 9. Such transitional rules provided secured parties a mechanism to bring pre-existing financing statements into compliance with Revised Article 9 during a five year transition period.

Banks should be aware that the transition period of revised Article 9 ended in Connecticut and most other states on June 30. It is also important to note that the transition period ending varies in some states and there are state specific issues that require banks to pay special attention. If there were pre-existing security interests under old Article 9 (and steps needed to be taken for such pre-existing security interests to remain effective under revised Article 9), to comply with the transition rules, such steps had to be taken prior to the ending of the transition period, in order to maintain perfection and priority of pre-existing security interests.

Filing Changes

Banks should be reminded that under revised Article 9, financing statements should be filed where the debtor is deemed located, in order to perfect a security interest in all personal property of the debtor that can be perfected by filing, except with respect to goods that are, or are to become, fixtures, timber to be cut or as-extracted collateral. This means that it is no longer necessary to file in the jurisdictions where the tangible assets of the debtor or guarantor are located.

During the transition period, in order to maintain perfection, banks could continue pre-existing financing statements filed under old Article 9 by filing an "in-lieu-of" financing statement in the proper jurisdiction, in accordance with revised Article 9, prior to the ending of the applicable transition period or by the lapse date – whichever came first. Further, banks could correct collateral descriptions which were incorrect under revised Article 9 by filing an "in-lieu-of" financing statement with the amended information in the proper jurisdiction in accordance with revised Article 9. Such an "in-lieu-of" financing statement would relate back to the earlier filed financing statement.

Now that the transition period has lapsed, it is too late for banks to file an "in-lieu-of" financing statement to preserve priority of an original filing and continue effectiveness of a financing statement filed in an incorrect of-

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fice. Once the transition period has expired, all pre-existing financing statements were either properly continued prior to the ending of the applicable transition period or are ineffective as a matter of law. Now banks will be required to file a new financing statement in accordance with revised Article 9 and in doing so, will lose continued perfected status and "reach-back" priority for any earlier filed financing statement.

Attendant Changes

For many practitioners, the real fruit of all the labor of the transition rules and revised Article 9 is the streamlining of the process of conducting debtor searches. Until the ending of the applicable transition period, banks in Connecticut had the somewhat onerous task of searching for financing statements in both the locations where financing statements were required to be filed in under old Article 9 and in the location where a financing statement was required to be filed in under revised Article 9. Add to this the fact that banks, when searching, needed to consider collateral descriptions appropriate under both the old and revised Article 9, due to the fact that collateral descriptions in a financing statement filed under old Article 9 were sufficient to perfect, until either the ending of the applicable transition period or the date such financing statement was continued.

Fortunately, banks will no longer be required to perform searches in accordance with both old and revised Article 9. The final, modern rule is the logical choice: for most types of collateral, banks only need to search for UCC financing statements in the state where the debtor is located, not where the collateral is located. Hence, the determination that banks need to make is, of course, where a debtor is located and then conduct searches in the jurisdiction of the debtor's location. Out of an abundance of caution, however, banks may wish to consider continuing to perform searches in accordance with both old and revised Article 9 for a short period of time after the expiration of the last transition period.

An additional challenge banks face in conducting debtor searches is that some liens may be "hidden" and may not be revealed based on the "correct" debtor name, as defined in section 9-506(c) of revised Article 9. Since the transition rules allowed financing statements effective under old Article 9 to remain effective until time to continue, if no other action was required, there was a risk that financing statements would not be revealed when conducting a search under the "correct" debtor name under revised Article 9. In order to comply with revised Article 9, banks needed to conduct broad enough searches to reveal these "hidden liens," which meant using every possible variation of the debtor's name. This was problematic, costly and inefficient for banks.

Fortunately, section 9-506(c) under revised Article 9 provides a safe harbor for banks by shifting the risk of name errors on financing statements from the searcher to the filer. Section 9-506(c) provides that if a search of the filing office records under the debtor's correct name – using the filing office's standard search logic – would disclose the financing statement with the erroneous name, the name on the financing statement is not seriously misleading. Thus, when searching for effective UCC financing statements, banks only need to ascertain the correct name from the debtor's formation documents and conduct a single search under that name. Although the safe harbor provides some safeguards for banks when conducting searches, with respect to certain types of debtors (such as individuals), it may be difficult to determine with certainty the one correct name and, in those cases, banks may want to continue to search and file under multiple names.

Now that the transition period has expired in most states, if the proper location of filing under both old and revised Article 9 was the same, the "hidden lien" issue is in most cases eliminated, as long as banks search the "correct" name and file financing statements under the "correct" name. However, it must be remembered that other types of liens, such as tax and judgment liens and pending litigation, are not governed by revised Article 9 and are governed by the law of the individual states, so additional analysis and searches may warranted.

A Final Word on Protocol

The transition period between old and revised Article 9 has required diligence, vigilance and a good grasp of the transitional rules. The banking industry has had to deal with the spectrum of the loss of perfection or priority of existing security interests during this time period. The end of the transition period under revised Article 9, however, means that filing and searching, while still requiring continued diligence, is now logical and intuitive. ■

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