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UNIFORM COMMERCIAL CODE, ARTICLE 9

House Bill 5228 as enrolled
Public Act 348 of 2000
Sponsor: Rep. Andrew Richner

House Bill 5402 as enrolled
Public Act 349 of 2000
Sponsor: Rep. Jim Howell

House Bill 5403 as enrolled
Public Act 350 of 2000
Sponsor: Rep. Charles LaSata

House Bill 5404 as enrolled
Public Act 351 of 2000
Sponsor: Rep. Mike Bishop

House Bill 5405 as enrolled
Public Act 352 of 2000
Sponsor: Rep. Jack Minore

House Bill 5406 as enrolled
Public Act 353 of 2000
Sponsor: Rep. Joanne Voorhees

House Bill 5407 as enrolled
Public Act 354 of 2000
Sponsor: Rep. Bruce Patterson

House Bill 5408 as enrolled
Public Act 355 of 2000
Sponsor: Rep. Michael Switalski

House Bill 5409 as enrolled
Public Act 356 of 2000
Sponsor: Rep. Marc Shulman

House Bill 5410 as enrolled
Public Act 426 of 2000
Sponsor: Rep. Alan Sanborn

House Bill 5411 as enrolled
Public Act 357 of 2000
Sponsor: Rep. Jennifer Faunce

House Bill 5412 as enrolled
Public Act 358 of 2000
Sponsor: Rep. Janet Kukuk

House Bill 5413 as enrolled
Public Act 359 of 2000
Sponsor: Rep. Doug Hart

House Bill 5415 as enrolled
Public Act 360 of 2000
Sponsor: Rep. Gloria Schermesser

House Bill 5416 as enrolled
Public Act 361 of 2000
Sponsor: Rep. Laura Baird

House Bill 5417 as enrolled
Public Act 362 of 2000
Sponsor: Rep. Gerald Law

House Committee: Family and Civil Law
Senate Committee: Financial Services

House Bill 5758 as enrolled
Public Act 363 of 2000
Sponsor: Rep. Andrew Richner

House Committee: Criminal Law and
Corrections
Senate Committee: Financial Services

Third Analysis (1-16-01)

House Bills 5228, 5402-5413, 5415-5417, and 5758 (1-16-01)

THE APPARENT PROBLEM:

Article 9 of the Uniform Commercial Code (UCC) is the law in every state, as well as the District of Columbia and Puerto Rico. It has governed the mechanics of granting credit and enforcing creditors' rights in the United States for four decades. Trillions of dollars of commercial and consumer credit are granted each year in secured transactions under Article 9—for example, a manufacturer financing the acquisition of a machine, a retailer financing inventory, or a consumer financing furniture for a new home.

Article 9 provides a set of rules that govern any transaction, other than a finance lease, that involves the granting of credit coupled with a creditor's interest in a debtor's personal property. If the debtor defaults, the creditor may take possession of and sell the property (generally called collateral) to satisfy the debt. The creditor's interest is called a “security interest.” Article 9 specifies how enforceable security interests may be created, perfected and enforced, and who has the first rights in the collateral when two or more competing creditors have legally enforceable interests in the collateral. Attachment and perfection of security interests are the two most important events in the creation of a security interest. “Attachment” generally occurs when the security interest becomes effective between the debtor and creditor -- usually as provided in the agreement between the parties. “Perfection” occurs when a creditor establishes his or her “priority” over other creditors for the same collateral. Perfection usually results from the filing of a financing statement in the appropriate public record. Usually (but not always), the first creditor to file has first priority, second to file has the next priority, and so on. This is because the existence of the filed financing statement ostensibly gives notice to other creditors of the existence of a claim on the collateral. Furthermore, any secured creditor (one who has filed a financing statement) has priority over all unsecured creditors.

However, Article 9 is fraught with exceptions to these rather simple basic rules. What constitutes perfection (filing is not the only means of perfection) is dependent upon the kind of property that is collateral. In addition to filing, perfection can in some instances be maintained through possession, attachment, or control (in some cases a creditor with control may have priority over one who has perfected his or her interest through filing).

For all of its importance, Article 9 has not been updated since 1972, and the world has changed significantly since then. In 1990 the Permanent

Editorial Board for the UCC, under the auspices of the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL), approved the establishment of a study committee to review the subject. The study committee issued its report in December of 1992, and in 1993 a drafting committee was established. A final draft of the article was approved by the ALI in May of 1998 and by the NCCUSL in July of 1998. As of January of 2000, Arizona, California, Maryland, Montana, Nebraska, Nevada, and Texas have all adopted the revised UCC Article 9. Legislation has been introduced in several other states, including Michigan, to adopt the revisions. Given the nationwide import of Article 9, it is the hope of the Uniform Law Commissioners that the revision will be enacted by all fifty states on or before its effective date of July 1, 2001.

THE CONTENT OF THE BILLS:

House Bill 5228 would revise and implement revisions of Article 9 of the UCC that have been recommended by the National Conference of Commissioners on Uniform State Laws. (Much of the explanation reported below is excerpted from materials supplied by the national conference.)

Summary of Revisions. Following is a brief summary of some of the more significant revisions of Article 9 that are included in the bill.

Scope of Article 9. The bill will expand the types of property that can be treated as collateral under Article 9 in several respects, thus allowing more kinds of transactions to be covered under Article 9's provisions. The following are types of property that are not currently subject to Article 9, but would be subject to the new article.

Deposit accounts. The bill would allow deposit accounts to be treated as original collateral, except in consumer transactions. The current Article 9 deals with deposit accounts only as proceeds of other collateral.

Sales of payment intangibles and promissory notes. The bill would include most sales of “payment intangibles” (defined as general intangibles under which an account debtor's principal obligation is monetary) and “promissory notes” as possible collateral. Current law includes sales of accounts and

chattel paper as potential collateral, but does not include sales of payment intangibles or promissory notes.

Health care insurance receivables. While transfers of interests in insurance policies would continue to be generally excluded from being collateral, a health care insurance receivable would be included within the definition of “account” and would not be part of the general exclusion.

Consignments. A consignment is a delivery of goods by an owner to another person, who sells the goods for the consignor. The bill would generally treat a consignor as holding a purchase money security interest against the consignee’s secured creditors.

Commercial tort claims. Article 9’s new scope would allow a security interest to be taken in “commercial tort claims” by narrowing the general exclusion of tort claims. However, tort claims for bodily injury and other non-business tort claims of a natural person would still be excluded. The bill would define “commercial tort claim” as a claim arising in tort where the claimant is either an organization or is an individual and the claim arises in the course of his or her business or profession and doesn’t include damages for personal injury or death.

Supporting obligations and property securing rights to payment. The new article also addresses explicitly (a) obligations, such as guaranties and letters of credit, that support payment or performance of collateral such as accounts, chattel paper, and payment intangibles, and (b) any property (including real property) that secures a right to payment or performance that is subject to an Article 9 security interest. (However, the creation or transfer of an interest in or lien on a land contract mortgage would be specifically excluded from the article’s control.)

Nonassignable general intangibles, promissory notes, health care insurance receivables, and letter-of-credit rights. The new article would allow a security interest to attach to letter-of-credit rights, health care insurance receivables, promissory notes, and general intangibles, including contracts, permits, licenses, and franchises, notwithstanding a contractual or statutory prohibition against or limitation on assignment. The article would also explicitly protect third parties against any adverse effect of the creation or attempted enforcement of the security interest.

Generally, the inclusion of transactions and collateral within the scope of Article 9 will have no effect on

non-Article 9 law dealing with the alienability or inalienability of property. For example, if a commercial tort claim is nonassignable under other applicable law, the fact that a security interest in the claim is within the scope of Article 9 would not override the other applicable law’s effective prohibition of assignment.

Duties of Secured Party. This article provides for expanded duties of secured parties.

Release of control. A secured party with control of a deposit account, investment property, or a letter-of-credit right would have a duty to release control when there was no secured obligation and no further commitment to give value. The bill also contains analogous provisions when an account debtor has been notified to pay a secured party.

Information. A secured party would have an expanded duty to provide the debtor with information concerning collateral and the obligations that it secures. The charge for requested information would be increased from \$10 to \$25; however, a debtor would remain entitled to one free request every six months.

Default and enforcement. A secured party would also have some additional duties in connection with default and enforcement. For example, the secured party would have a duty to explain calculation of deficiency or surplus in a consumer-goods transaction.

Choice of Law. Secured transactions may involve more than one state. The creditor may be in one state, the debtor in another, and the collateral in another; furthermore, any of the three may move from one state to another during the life of the transaction. As a result, Article 9 contains rules to determine which state’s law applies to the perfection, effect of perfection, and priority of creditors. There are two major changes to the choice of law provisions in the new article.

1) *Where to file.* The new Article 9’s provisions would change the choice of law rule governing perfection (i.e., where to file) for most collateral to the law of the jurisdiction where the debtor is located. Under current law, the jurisdiction of the debtor’s location governs only perfection and priority of a security interest in accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property.

2) *Determining debtor’s location.* The baseline rule for determining the location of the debtor would remain the

debtor's place of business (or chief executive office, if the debtor has more than one place of business). However, the bill contains three major exceptions. First, a "registered organization," such as a corporation or limited liability company, would be located in the state under whose law the debtor was organized, e.g., a corporate debtor's state of incorporation. Second, an individual debtor would be located at his or her principal residence. Third, there are special rules for determining the location of the United States and registered organizations organized under the law of the United States.

Location of non-U.S. debtors. If, applying the foregoing rules, a debtor is located in a jurisdiction whose law does not require public notice as a condition of perfection of a nonpossessory security interest, the entity would be deemed to be located in the District of Columbia. Thus, to the extent that the article applied to non-U.S. debtors, perfection could be accomplished in many cases by a domestic filing.

Exceptions. Perfection, the effect of perfection or nonperfection, and priority of possessory security interests and agricultural liens would be governed by the law of the jurisdiction where the collateral was located. Deposit accounts would be governed by the law of the location of the bank. Goods covered by certificates of title, and minerals, letter-of-credit rights, and investment property would continue to be subject to the law of the place where the collateral was located.

The law governing perfection is different from the law governing the effect of perfection and priority for negotiable documents, goods, instruments, money and tangible chattel paper. The effect of perfection and priority of nonpossessory security interests in these types of collateral would be determined by the location of the collateral. Thus, the place to file or the place where automatic perfection takes place is the location of the debtor, but the impact of filing may be determined by the law of the state where the collateral is located.

Perfection. A security interest is perfected when the secured creditor has met the statutory requirements for notice to later creditors. There are four basic kinds of perfection: 1) by filing; 2) by possession; 3) by control; and 4) automatic perfection. Unless otherwise noted, conflicting security interests take priority in order of filing or other perfections in time, and first in time usually takes priority.

Filing. Filing a financing statement in the appropriate place of record maintained by the state would perfect

almost every kind of security interest, even if another means of perfection were available.

Possession. A secured party could perfect his or her interest in a wide range of collateral by taking possession of the collateral. Possession would be the only way to perfect an interest in money, unless it is proceed from a sale of property subject to a security interest.

Control. A creditor is deemed to have control when the debtor's interest can be transferred without the debtor's consent. The revisions would allow a creditor to perfect an interest in deposit accounts and letter-of-credit rights, in addition to investment property, by control. In fact, control would be the only way to perfect an interest in deposit accounts and letter-of-credit rights. It would be possible to perfect an interest in investment property by filing; however, perfection by control would always have priority over perfection by filing in such cases.

Automatic perfection. Generally, public notice is required to perfect a security interest in collateral. However, there are various types of security interests that do not require public notice for perfection, and thus are considered automatically perfected (e.g., purchase-money security interests in consumer goods other than automobiles). Automatic perfection would be extended to a transfer of a health care insurance receivable to a health care provider. Automatic perfection would also apply to security interests created by sales of payment intangibles and promissory notes. A perfected security interest in collateral supported by a "supporting obligation" (such as an account supported by a guaranty) would also be a perfected security interest in the supporting obligation, and a perfected security interest in an obligation secured by a security interest or lien on property (e.g., a real property mortgage) would also be a perfected security interest in the security interest or lien. A purchase money security interest (PMSI) in consumer goods would also be automatically perfected. It is the only type of automatic perfection that would not be merely temporary. The article allows PMSIs to be taken on computer software and livestock.

Electronic chattel paper. "Electronic chattel paper" is a new term that would describe a record or records consisting of information stored in an electronic medium (i.e., it is not written). Perfection of a security interest in electronic chattel paper could be by made by control or filing.

Instruments, agricultural liens, and commercial tort claims. The new article would expand the types of collateral in which a security interest may be perfected by filing to include instruments. Agricultural liens and security interests in commercial tort claims would also be perfected by filing.

Possessory security interests. Several provisions of the new article address aspects of security interests involving a secured party or a third party who is in possession of the collateral. Some of the changes resolve uncertainties in the current language. The bill provides that if a third party has a possession of the collateral, a security interest could be perfected by the third party's acknowledgment, in an authenticated record, that the third party is holding the collateral for the secured party's benefit. However, a third party would not be required to make such an acknowledgment and, if it did, the acknowledgment would not impose any duties on the third party, unless it otherwise agreed. Further, if a secured party already is in possession of the collateral, its security interest would remain perfected by possession, even if it delivered the collateral to a third party, provided that the collateral was accompanied by instructions to hold it for the secured party or to redeliver it to the secured party. The new article also clarifies the limited circumstances under which the secured party, by taking possession, could perfect a security interest in goods covered by a certificate of title.

Priority. The new article includes several new priority rules and some special rules relating to banks and deposit accounts.

Purchase-money security interests: general; consumer-goods transactions; inventory. The provisions that explain purchase-money security interests (PMSI) (although the term is not formally "defined") would be substantially re-written. The substantive changes, however, apply only to non-consumer-goods transactions. (Consumer transactions and consumer-goods transactions are discussed below.) For non-consumer-goods transactions, the new language would provide that a security interest in collateral could be (to some extent) both a PMSI as well as a non-PMSI, in accord with the "dual status" rule applied by some courts under current Article 9 (thereby rejecting the "transformation" rule). The definition provides an even broader conception of a PMSI in inventory, yielding a result that accords with private agreements entered into in response to the uncertainty under current Article 9. These provisions treat consignments as purchase-money security interests in inventory. They revise the PMSI priority rules, but for the most part without material change in

substance, and clarify the priority rules for competing PMSIs in the same collateral.

Purchase-money security interests in livestock; agricultural liens. The bill would retain Michigan's existing language with regard to farm products, rather than including the new act's provisions that would allow production money security interests (similar to purchase money security interests) to be taken in farm products. The existing Michigan law requires a debtor who is engaged in farming operations to provide the secured party with a list of potential buyers of the farm products. The secured party is responsible for notifying the potential buyers of the existence of the security interest in the farm products and payment is generally expected to be made jointly to the debtor and the secured party.

Purchase-money security interests in software. Along with the new definition of "software", the new article contains a new priority rule for a software purchase-money security interest. A software PMSI includes a PMSI in software that is used in goods that are also subject to a PMSI. (Note also that the definition of "chattel paper" has been expanded to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods.)

Investment property. Under the new article, the priority rules for investment property are substantially similar to the priority rules found in current law, which were added in conjunction with the 1994 revisions to UCC Article 8. If a secured party has control of investment property, its security interest would be senior to a security interest perfected in another manner (e.g., by filing). Also, security interests perfected by control would generally rank according to the time that control is obtained or, in the case of a security entitlement or a commodity contract carried in a commodity account, the time when the control arrangement is entered into. This is a change from current law, under which the security interests rank equally. However, between a securities intermediary's security interest in a security entitlement that it maintains for the debtor and a security interest held by another secured party, the securities intermediary's security interest would be senior.

Deposit accounts. The new priority rules applicable to deposit accounts are patterned on and are similar to those for investment property. If a secured party has control of a deposit account, its security interest would be senior to a security interest perfected in another manner (i.e., as cash proceeds). In addition, security

interests perfected by control would be ranked according to the time that control is obtained, but between a depositary bank's security interest and one held by another secured party, the depositary bank's security interest would be senior. A corresponding rule would make a depositary bank's right of set-off generally senior to a security interest held by another secured party. However, if the other secured party became the depositary bank's customer with respect to the deposit account, then its security interest would be senior to the depositary bank's security interest and right of set-off.

Letter-of-credit rights. Under the bill, the priority rules for security interests in letter-of-credit rights are somewhat analogous to those for deposit accounts. A security interest perfected by control would have priority over one perfected in another manner (i.e., as a supporting obligation for the collateral in which a security interest is perfected). Security interests in a letter-of-credit right perfected by control would be ranked according to the time that control is obtained. However, the rights of a transferee beneficiary or a nominated person would be independent and superior to the extent provided in the bill.

Chattel paper and instruments. As under the current law, differing priority rules would apply to purchasers of chattel paper who give new value and take possession of the collateral (or, in the case of electronic chattel paper, obtain control of the collateral), depending on whether a conflicting security interest in the collateral is claimed merely as proceeds. The principal change relates to the role of knowledge and the effect of an indication of a previous assignment of the collateral. The new language also affords priority to purchasers of instruments who take possession in good faith and without knowledge that the purchase violates the rights of the competing secured party. In addition, to qualify for priority, purchasers of chattel paper, but not of instruments, would have to purchase in the ordinary course of business.

Proceeds. The new definition of "proceeds" of collateral would include additional rights and property that arise out of collateral, such as distributions on account of collateral and claims arising out of the loss or nonconformity of, defects in, or damage to collateral. The term also includes collections on account of "supporting obligations," such as guarantees. There are new priority rules that would clarify when a special priority of a security interest in collateral continues or does not continue with respect to proceeds of the collateral.

Miscellaneous priority provisions. The new article also includes (i) clarifications of selected good-faith-purchase and similar issues; (ii) new priority rules to deal with the "double debtor" problem arising when a debtor creates a security interest in collateral acquired by the debtor subject to a security interest created by another person; (iii) new priority rules to deal with the problems created when a change in corporate structure or the like results in a new entity that has become bound by the original debtor's after-acquired property agreement; (iv) a provision enabling most transferees of funds from a deposit account or money to take free of a security interest; (v) substantially rewritten and refined priority rules dealing with accessions and commingled goods; (vi) revised priority rules for security interests in goods covered by a certificate of title; and (vii) provisions designed to ensure that security interests in deposit accounts will not extend to most transferees of funds on deposit or payees from deposit accounts and will not otherwise "clog" the payments system.

Additional Provisions Relating to Third-Party Rights. Part 4 of the new article, entitled "Rights of Third Parties", contains several provisions relating to the relationships between certain third parties and the parties to secured transactions which under current law are scattered throughout the article. Most of them are essentially unchanged, but for updated language and the inclusion of references appropriate to the expanded scope of the article. The new language would provide that with regard to rights that were acquired by an assignee, where the record did not include a required statement limiting the debtor's recovery to amounts paid, the debtor's recovery would be treated as though the record had included the required statement. The provisions regarding the rights of an assignee, modification of contracts, and discharge of an account debtor would not apply to assignments of health care insurance receivables and would be subject to consumer protections laws.

The new article contains new sections regarding the alienability of debtor's rights; providing that a secured party is not obligated on debtor's contracts; agreements not to assert defenses against an assignee; the rights acquired by an assignee; modification of assigned contracts; discharge of account debtors, rendering restrictions on assignment of account, chattel paper, promissory note, or payment intangible ineffective; making restrictions on creation or enforcement of security interest in leasehold interest or lessor's residual interest ineffective. It also contains new sections that make provisions that would restrict the assignment of promissory notes, health care

insurance receivables, and certain general intangibles ineffective and make restrictions on assignment of letter-of-credit rights ineffective.

Filing. The primary and principal method for perfecting a security interest under the new Article 9 is to file a financing statement with the filing authority. The new system of filing is designed to create a more uniform system that is simpler and easier to use.

Medium-neutrality. The new system is designed to be “medium-neutral”; that is, it makes clear that parties could file and otherwise communicate with a filing office by means of records communicated and stored in media other than on paper.

Identity of person who files a record; authorization. The new article is largely indifferent as to the person who effects a filing. This approach is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system (except to the extent that filing offices may choose to employ authentication procedures in connection with electronic communications). As long as the appropriate person *authorizes* the filing, or, in the case of a termination statement where the debtor is entitled to the termination, it is largely insignificant whether the secured party or another person files any given record.

In general, the debtor’s authorization would be required for the filing of an initial financing statement or an amendment that adds collateral. With one further exception, a secured party of record’s authorization would be required for the filing of other amendments. The exception arises if a secured party has failed to provide a termination statement that is required because there is no outstanding secured obligation or commitment to give value. In that situation, a debtor would be authorized to file a termination statement indicating that it has been filed by the debtor.

Financing statement formal requisites. The requirements for a financing statement would be significantly simplified. A financing statement would provide the name of the debtor and the secured party and an indication of the collateral that it covers. No signatures would be required and the identity of the person who does the actual filing is irrelevant. The article sets forth guidelines for when a name provided on a financing statement is sufficient depending upon the type of entity that is being named to clarify when a debtor’s name is correct and when an incorrect name is insufficient. In addition, a financing statement’s description of covered collateral would be sufficient if it reasonably identifies what is described or contains a

generic statement that the financing statement covers “all assets” or “all personal property.” (Note, however, that a generic description would be inadequate for purposes of a security agreement.) The effectiveness of a record would not be hindered by a filing office’s failure to correctly index the record. Further, to facilitate electronic filing, the new article would not require that the debtor’s signature or other authorization appear on a financing statement. Instead, it would prohibit the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition.

Filing-office operations. Under the recommended uniform law, every state would have a central filing authority. The only exception would be for fixture filings, which continue to be made (and searched) in the real estate records. In Michigan, the central filing authority would be the secretary of state. The secretary of state’s office would be required to adopt and publish rules to implement the article. The secretary of state would also be expected to consult with the most recent versions of the model rules, other filing offices in other jurisdictions, and take into consideration the rules, practices and technology used by jurisdictions in adopting, amending, and repealing filing-office rules.

Other changes for filing offices would include: First, a filing office would have no discretion to reject an initial financing statement or other record for any reason other than failure to provide the record in an appropriate media, failure to pay the full filing fee, or failure to include the required information. A record that was rejected for other reasons would still be considered to be valid. Second, a filing office would be required to link all subsequent records (e.g., assignments, continuation statements, etc.) to the initial financing statement to which they relate. Third, the filing office could delete a financing statement and related records from the files no earlier than one year after lapse (lapse normally is five years after the filing date), and then only if a continuation statement has not been filed. Thus, a financing statement and related records would be discovered by a search of the files even after the filing of a termination statement. Fourth, the new article would mandate performance standards for filing offices. Fifth, it provides that filing offices could promulgate rules to deal with those details best left out of the statute and requires the filing office to submit periodic reports. Sixth, a provision that allows registers of deeds to charge 50 cents extra for chattel instruments or financing statements that were not prepared on 8 ½ x 13 inch paper would be removed. Seventh, a filing office would have to offer copies of all the records filed under Article 9 in every medium.

The copies would be available to the public at the same rates as are charged for record searches and would have to be updated on an at least weekly basis.

Correction of records: Defaulting or missing secured parties and fraudulent filings. In order to deal with the problems created by the filing of fraudulent financing statements against public officials and other persons, the new article would allow a debtor to file a termination statement when a secured party wrongfully refuses or fails to provide a termination statement. This would also address the problem of secured parties that simply disappear through mergers or liquidations. In addition, the article would provide a statutory method by which a debtor who believed that a filed record was inaccurate or was wrongfully filed could indicate that fact in the files by filing a correction statement, albeit without affecting the efficacy, if any, of the challenged record.

Extended period of effectiveness for certain financing statements. Generally, financing statements are effective for five years unless a continuation statement is filed to continue the effectiveness for another five years. However, the new article would provide that an initial financing statement filed in connection with a “manufactured-home transaction” would be effective for 30 years.

National form of financing statement and related forms. The new article would provide for and describe uniform, national written forms of financing statements and related written records that would have to be accepted by a filing office that accepts written records.

Default and Enforcement. When a debtor defaults on an obligation secured under Article 9, a secured creditor has a right to take the collateral, sell that collateral, and apply the proceeds to pay off the debt. If the proceeds are insufficient to meet the debt, the debtor may be obligated to pay off the deficiency. If there is a surplus, the surplus will be paid to the debtor, unless there are other creditors who act to obtain satisfaction of their debts. The revisions would not fundamentally alter the rules for enforcement of a security interest on debtor’s default.

Rights and duties of secondary obligor. Under the bill, a secondary obligor would obtain the rights and assume the duties of a secured party if the secondary obligor receives an assignment of a secured obligation, agrees to assume the secured party’s rights and duties upon a transfer to it of collateral, or becomes subrogated to the rights of the secured party with respect to the collateral. The assumption, transfer, or subrogation is not a

disposition of collateral, but it does relieve the former secured party of further duties. The current law does not address whether a secured party is relieved of its duties in this situation.

Debtor, secondary obligors; waiver. The revisions would clarify who has rights and to whom a secured party owes specified duties when a default occurs. Generally, the rights and duties would be enjoyed by and run to the “debtor,” defined to mean any person with a non-lien property interest in collateral, and to any “obligor.” With the exception of consumer obligors, the rights and duties concerned affect non-debtor obligors only if they are “secondary obligors.” “Secondary obligor” is defined to include one who is secondarily obligated on the secured obligation, e.g., a guarantor, or one who has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. However, the secured party would be relieved from any duty or liability to any person unless the secured party knows that the person is a debtor or obligor. This article generally prohibits waiver by a secondary obligor of its rights and a secured party’s duties when a default occurs. However, a secondary obligor or debtor could waive the right to notification of disposition of collateral and, in a non-consumer transaction, the right to redeem collateral, but only after the default occurs.

Rights of collection and enforcement of collateral. The bill’s explanation of the rights of a secured party who seeks to collect or enforce collateral, including accounts, chattel paper, and payment intangible, would provide greater detail than the current language. It also would set forth the enforcement rights of a depository bank holding a security interest in a deposit account maintained with the depository bank. These provisions relate solely to the rights of a secured party vis-a-vis a debtor with respect to collections and enforcement. They would not affect the rights or duties of third parties, such as account debtors on collateral, which are addressed elsewhere. The new article would also clarify the manner in which proceeds of collection or enforcement are to be applied.

Disposition of collateral: Warranties of title. The new article would impose the warranties of title, quiet possession, and the like that are otherwise applicable under other law on a secured party who disposes of collateral. It also would provide rules for the exclusion or modification of those warranties.

Disposition of collateral: Notification, application of proceeds, surplus and deficiency, other effects. A

secured party would be required to give notification of a disposition of collateral to other secured parties and lienholders who have filed financing statements against the debtor covering the collateral. However, the provision would relieve the secured party from that duty when the secured party undertakes a search of the records and a report of the results is unreasonably delayed. Generally, whether notice was sent within a reasonable amount of time is a question of fact; however, in the case of non-consumer transactions, the article specifies what would have to be included in a notification of disposition and provides that a notification sent 10 days or more before the earliest time for disposition is sent within a reasonable time. The article provides forms and notification in consumer and non-consumer transactions, which when completed provide sufficient notice. The article also lists the information needed to provide sufficient notice if the forms are not used. Regardless of the notice's format, it would be adequate if it contains the required information. Any errors that are not seriously misleading in non-consumer goods transactions or that are not misleading with respect to rights provided under the article in a consumer transaction would not void the notice.

Transfer of record or legal title. A new provision would make it clear that a transfer of record or legal title to a secured party in order to facilitate a disposition would not of itself constitute a disposition. This rule would apply regardless of the circumstances under which the transfer of title occurs.

Strict foreclosure. Under the new article, a secured party would be permitted (except in a consumer goods transaction) to accept collateral in partial satisfaction, as well as full satisfaction, of the obligations secured. This right of strict foreclosure would extend to intangible as well as tangible property. The new article also takes into account the effects of an acceptance of collateral on the rights of junior claimants. Acceptance of collateral in satisfaction of a debt could not be, in and of itself, considered an unreasonable delay of disposition. Strict foreclosure would be permissible if it was commercially reasonable, and unreasonable delay could occur only if the foreclosure itself was not commercially reasonable.

Notification to junior creditors. Under the new article, a secured party who took collateral and disposed of it upon default would have a broader obligation to notify other secured parties and lien holders who have filed financing statements against the debtor on the same collateral than under current law. The article contains specific notification requirements, and the notification

would have to be given within a reasonable time (no less than 10 days after the earliest time of disposition of collateral).

Effect of noncompliance: "Rebuttable presumption" test. In non-consumer goods transactions, a secured party would be presumed to have complied with certain provisions of the article relating to collection, enforcement, disposition, or acceptance, unless the debtor or secondary obligor placed the secured party's compliance at issue. If the secured party was then unable to prove that he or she had complied with those requirements, the article would require that the debtor or secondary obligor be credited with the difference between the actual disposition price and the price that would have been paid if the disposition had been conducted in a commercially reasonable manner. For non-consumer transactions, the article would specify that it intended to leave determination of the proper rules in consumer goods transactions to the courts, but that the courts could not infer the nature of the proper rule in these cases from the limitations on non-consumer goods transactions and that the courts could continue to apply established approaches.

"Low-price" dispositions: Calculation of deficiency and surplus. The new article addresses the problem of procedurally regular dispositions that fetch a low price. It provides a special method for calculating a deficiency if the proceeds from the disposition of the collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought." In these situations there is reason to suspect that there may be inadequate incentives to obtain a better price. Consequently, instead of calculating a deficiency (or surplus) based on the actual net proceeds, the deficiency (or surplus) would be calculated based on the proceeds that would have been received in a disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor.

Consumer Goods, Consumer-Goods Transactions, and Consumer Transactions. The new article (including the accompanying conforming revisions) includes several special rules for "consumer goods," "consumer transactions," and "consumer-goods transactions." Consumer or consumer goods transactions are those where an individual incurs an obligation involving a security interest on collateral that is primarily for personal, family, or household purposes. The revisions would make a distinction

between a consumer debtor and a consumer obligor. Usually they are the same person, but there are occasions where a person can be an obligor, but not the debtor – for example, a person who guarantees the payment of the debtor’s debt. Most of the special rules regarding consumer transactions pertain to enforcement of a security interest after the debtor defaults on the obligation. However, the article would provide special requirements for the contents of a notification of disposition and a safe-harbor, “plain English” notification form for consumer-goods transactions.

Right to redeem. A consumer debtor could not waive his or her right to redeem the collateral taken to satisfy the debt (that is, the right to have the collateral returned upon satisfaction of the debt after a default). Any attempt at such a waiver would be deemed ineffective.

Purchase money status. The requirements regarding the allocation of payments for determining extent of purchase-money status; the effect of cross-collateralization, refinancing, restructuring, or the like on purchase money status; and the secured party’s burden of establishing extent of purchase-money status would not apply to consumer-goods transactions. Furthermore, the limitation of those provisions to transactions other than consumer-goods transactions leaves to the courts the proper rules for consumer-goods transactions and prohibits the courts from drawing inferences from that limitation.

No dual status rule. Generally, the revisions would specify that the same collateral could secure both a purchase money security interest (PMSI) and a non-PMSI. However, in the case of consumer transactions, the revisions would provide that the courts would have to determine whether to apply this rule or another rule.

Sufficient description. A description of consumer goods, a security entitlement, a security account, or a commodity account in a consumer transaction could not be made by category only.

Pre-payment rights. A consumer buyer who paid in whole or in part before goods were delivered would have enhanced rights to possession of the goods, thereby accelerating the opportunity to achieve “buyer in ordinary course of business” status.

Deficiency statement. A consumer debtor or obligor would be entitled to a written statement from the secured party that explains what is owed after the collateral has been sold to satisfy the debt and explains how it calculated that deficiency. This would have to

be provided when the secured party first undertakes to collect the deficiency.

No partial satisfaction. A secured party could not accept collateral as partial satisfaction of a consumer debt.

Preservation of claims and defenses. A consumer’s rights to assert claims and defenses would be preserved, even if the record did not contain certain statements that are required in another law to preserve those rights.

Good Faith. The definition of “good faith” would include not only “honesty in fact” but also “the observance of reasonable commercial standards of fair dealing.” The definition is similar to the ones adopted in connection with other, recently completed revisions of the UCC.

Filing fees. Except for records of a fixture filing or covering as-extracted collateral or timber to be cut, the fee for filing and indexing a record would be \$10, however additional amounts could be added as follows: If the record were more than 100 pages long, an extra \$12 could be charged. An additional \$7 could be charged if the financing statement or amendment to a financing statement was in a form other than the article’s recommended form. If the filing office had to index more than two names, an additional \$10 could be charged per extra name.

Record searches. The charge for a record search would be \$6. If the party requesting the search requested a certificate and the search disclosed more than 100 currently effective records filed concerning that debtor, an additional \$6 would be charged. If the person requested an expedited search, an additional \$25 would be charged. If the person requested copies of the currently effective records disclosed by the search, an additional \$2 per page would be charged. If the filing office was the secretary of state and the person making the request asked for an impression official seal on the certificate, an additional \$6 would be charged. These fees would not apply to fixture filings and filings as-extracted collateral or timber to be cut.

Transition Provisions. Part 7 contains transition provisions. Generally, unless the section included an exception, the new article would apply to all aspects of a transaction. After the new article takes effect, a security interest that was perfected under the former article will remain perfected under the new article,

though not for the same length of time. A properly filed financing statement under the former article would remain effective (even though the filing might be in the wrong state under the new article) until the earlier of either a) the time the financing statement would lapse, or b) five years after the effective date of the new article. Perfection by a method other than filing would remain effective only for one year after the article's effective date, unless the interest were perfected under the new article during that time.

Conforming and Related Amendments to Other UCC Articles. Appendix I contains several proposed revisions to the provisions of other UCC articles. Cross-references in other UCC articles to sections of Article 9 also have been revised.

Effective date and repealers. The bill would have an effective date of July 1, 2001. This is the date recommended by the NCCUSL. The bill would repeal several sections that would be in conflict with new language or have been moved in substantially similar form to other areas in the article. However, a provision allowing the secretary of state to establish a subscription service for the sale in bulk of documents filed under Article 9 is not included in the new article.

Miscellaneous. The bill makes a technical amendment to correct an error in language that, if applied as written, would give a person who was leasing goods the right to take possession of those goods when he or she defaulted on the lease contract. The bill would correctly provide the lessor with the right to possession of the leased goods when the lessee was in default.

House Bills 5402 through 5413 and 5414 through 5417 would amend various acts to update references in those acts to comport with the new language of Article 9 of the UCC. House Bill 5402 would amend the Vietnam Veteran Era Bonus Act (MCL 35.1037); House Bill 5403 would amend the Revenue Bond Act (MCL 141.114); House Bill 5404 would amend the Uniform Federal Lien Registration Act (MCL 211.655); House Bill 5405 would amend the State Tax Lien Registration Act (MCL 211.684); House Bill 5406 would amend the Michigan Vehicle Code (MCL 257.58b); House Bill 5407 would amend Public Act 387 of 1978 (MCL 257.934); House Bill 5408 would amend the Grain Dealers Act (MCL 285.67a); House Bill 5409 would amend the Higher Education Facilities Authority Act (MCL 390.931); House Bill 5410 would amend Public Act 289 of 1976 (MCL 390.1355); House Bill 5411 would amend the Farm and Utility Equipment Act (MCL 445.1459); House Bill 5412 would amend the

Business Corporation Act (MCL 450.1471); House Bill 5413 would amend the Nonprofit Corporation Act (MCL 450.2471); House Bill 5415 would amend the Savings and Loan Act (MCL 491.420); House Bill 5416 would amend the Motor Vehicle Sales Finance Act (MCL 492.114); House Bill 5417 would amend the Uniform Fraudulent Transfer Act (MCL 566.38). House Bill 5758 would amend the Code of Criminal Procedure (MCL 777.14) to update references in the same manner as House Bills 5402-5417 and would reclassify the felony of operating a locomotive under the influence (third or subsequent offense) from Class F to Class E (Other drunk driving offenses are class E offenses).

House Bills 5404, 5405, 5407, 5408, 5416, 5417, and 5758 would take effect on July 1, 2001 and are tied to House Bill 5228 and would not take effect unless that bill were also enacted.

BACKGROUND INFORMATION:

This bill is one of several recommended to the Michigan legislature by the Michigan Law Revision Commission, in order to update and to recodify codes of law, including for example, the Uniform Commercial Code.

The National Conference of Commissioners on Uniform State Laws was created in 1892. The conference identifies outmoded statutes, substantiates its recommendations to eliminate those statutes with scholarly research, and then drafts uniform updated statutes. The updated "tentative" statutes are drafted over several years, allowing for ample review, argument, and revision. Revisions of the drafts are facilitated through a network of linkages constituted by scholars and practitioners who serve as members of the law sections of the federal and local bar associations, as well as those who serve as volunteer commissioners in state-level review commissions. These contexts provide an opportunity for stakeholders to study unacceptable statutes in light of emerging legal doctrines. The conference proposes the new statutes, first to the law sections, and then to the entirety of the American Bar Association for review by scholars, teachers of law, and legal practitioners. Once endorsed by the American Bar Association, the uniform statutes are disseminated to a network of state-level Uniform Law Commissions (for example, the Michigan Law Revision Commission), whose members review the proposals once again, and then in some instances recommend their introduction as bills in the state legislatures.

According to the conference, since its organization, the conference has drafted more than 200 uniform laws on many subjects and in various fields of law, setting patterns for uniformity across the nation. Uniform acts include the Uniform Commercial Code, the Uniform Probate Code, the Uniform Child Custody Jurisdiction Act, the Uniform Partnership Act, the Uniform Anatomical Gift Act and the Uniform Limited Partnership Act. Beginning in 1940, the conference made a significant decision to attack major commercial problems with comprehensive legal solutions--a decision that set in motion the project to produce the Uniform Commercial Code. The code took ten years to complete and another 14 years before it was enacted across the country. It remains the signature product of the conference. Today the conference is recognized primarily for its work in commercial law, family law, probate and estates, law of business organizations, health law, and conflicts in law. It rarely drafts law that is regulatory in character.

In Michigan, the Law Revision Commission has issued more than 30 annual reports, although the commission was created by statute in 1986 (MCL 4.1401). Each year the commission issues a report to describe the topics of its study reports, and to recommend statutes. Some statutes are enacted into law. Under its enabling statute, section 401 of Public Act 268 of 1986, the commission's membership is: four legislators to be bicameral and bipartisan, the director of the Legislative Service Bureau (or designee), and four members appointed by the Legislative Council. The Legislative Council designates the chair. The commission's reports are available at its web site, <http://www.dcl.edu>.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, House Bill 5228 would increase state revenue to the Department of State by an indeterminate amount. There would also be an indeterminate effect on the revenue generated locally through county registers of deeds. While the increased fees will tend to increase local revenue on fixture filings, this will be offset by the fact that many other filings will now be received by the Department of State. House Bills 5402 - 5413, 5415 - 5417 and 5758 would have no significant fiscal impact on the state or local units of government. (1-10-01)

ARGUMENTS:

For:

It has been 28 years since Article 9 of the UCC has been updated or revised. The revised Article 9 contains significant changes in the scope, rules, and

procedures regarding secured transactions. It will also update the article to recognize and work with the rapid growth of electronic commerce. It will not only serve to simplify and clarify many issues, but will also expand the types of property and transactions covered under the article. As a result, the revisions will bring greater certainty to an even larger number of transactions. Thus, the revised Article 9 will serve to reduce both transaction costs and the overall cost of credit.

The revisions will bring Article 9 into the age of intangible property and adapt it to modern financing techniques. The new Article 9 will, among other things, facilitate financing, reduce the costs of financing, bring greater certainty to financing transactions, and provide greater protections for debtors in the foreclosure process.

Against:

There are some concerns that the provisions of the revised Article 9 that would require all filings (except for fixtures) to be made centrally with the secretary of state could impact negatively on local units due to the loss of filing fee income. It has also been suggested that the same provisions could have a negative impact upon certain local parties to such transactions by requiring them to go to the secretary of state in order to make a filing or check on the status of a filing.

Analyst: W. Flory

#This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.