It Can Happen and It Does!
The Cases for UCC Insurance - Part 1 of 2

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Although UCC security interest priority insurance is now offered, or will soon be offered, by all major title insurance companies, market acceptance has been concentrated in a few unique market segments:

• UCC insurance has found wide acceptance in mezzanine lending, where the insurance can effectively insure the actual ownership of the equity interests of the mezzanine borrowers in the mortgagor borrower.
• For the lender involved in lower dollar transactions that usually close without lawyer involvement, UCC insurance provides significant benefits over reliance on the representations and warranties of the borrower by effectively insuring the organization of the borrower and the authorization, execution and delivery of the lien-granting document, such as the Loan and Security Agreement.
• For the lender without significant loan volume, and therefore without the clerical and paralegal infrastructure, the UCC insurance product, for the premium charged, will include preparation of all appropriate UCC-1 financing statements, filing of those financing statements in the appropriate jurisdictions, and placing the financing statements in various tracking systems to advise the lender of pending lapse dates. This feature has significant appeal to certain lender groups, such as SBA lenders and community banks, where outsourcing is of significant value.

Notwithstanding market validation, many market segments have been reluctant to utilize UCC insurance. The reluctance is based on three primary objections from lenders:

(1) “I am only selling money and an additional charge to my debtor for the insurance premium will make my money not competitive.”

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“My lawyers do all the work and I can always sue them if something goes wrong.”

“I have never had a loan loss due to UCC-related issues and so why do I need the insurance in the first place?”

Part 1 of this article will address the first two objections, and Part 2 (in the next issue of the Commercial Law Newsletter) will address the third objection.

The lender’s first two objections are fundamentally related. The lender complains that added insurance premiums will cost too much, and anyway the lawyers will be liable for any errors. The lender’s law firm, meanwhile, may want to preserve the fees that it traditionally receives for UCC work, but its fee structure does not really take into account its potential malpractice exposure.

The Role of Counsel and Malpractice Risk

The cost-effectiveness of UCC insurance, putting aside the insurance component discussed below, turns on a combination of outsourcing and other expense reduction. Legal services are not free. For those transactions that involve lawyers, usually the higher dollar transactions, the beginning point for discussing the utility of UCC insurance and its cost justification is a review of current practice in personal property secured transactions: What do counsel for lender and borrower now do and what do they leave undone? What does UCC insurance provide as replacements for, supplements to or improvements on current practice?

First of all, let us consider lender’s counsel and the pricing of legal fees. It is typical in a secured personal property secured transaction for lender’s counsel to do two things covered by UCC insurance: (a) examine the status of lien priority with respect to the assets of the borrower, and (b) to prepare and file the financing statements to perfect the lien of its client, the lender, in the assets of the borrower. In this context let us consider how the pricing of legal services is usually determined. There is no correlation between the hourly rates of attorneys and paralegals and the risk of malpractice exposure to the law firm from the service being performed. Hourly rates are set through a combination of what the market will bear and what the partners want to make, without any consideration of the risk associated with the service being performed.

Risk in Reviewing UCC Searches

In a commercial finance transaction, this author has observed that the greatest malpractice risk to a lender’s counsel is not in the negotiation and drafting of the primary loan documents, services requiring senior associate or partner attention, but rather the ordering and review of the existing financing statements encumbering the reliance collateral of the borrower. The initial ordering and review of the financing statements is usually performed by paralegals, who are often not as well trained as lawyers but equally overworked, and whose billing rate provides probably the lowest rate of return to the law firm. After the initial review of the financing statements, the paralegal will prepare a search summary chart listing the filed financing statements against the borrower by secured creditor and describing the financing statement as to the scope of the collateral covered, e.g., against specific equipment as in the case of an equipment lessor, or a blanket lien against all of the borrower’s assets filed by the borrower’s existing working capital lender. An attorney, usually a junior associate, will review the search summary chart, but usually, to avoid duplicating the costs of the paralegal, the associate will not review the underlying copies of the filings unless the paralegal is uncertain as to the scope of a filing. For example, unclear language associated with a purchase money filing against specific equipment which may encumber accounts or general intangibles that the lender views as reliance collateral. This might make the equipment filing unacceptable even though a filing against only the equipment and the proceeds thereof would have been acceptable as a senior or priming filing.
If the paralegal makes a mistake in this review process, a priming security interest may pass the process unreleased. If the borrower defaults and lien challenge occurs in a bankruptcy court over priority between the secured working capital lender and the equipment lessor, the law firm could end up writing a check to its client and perhaps lose the client over the mistake.

As an example, consider an actual situation where counsel representing a lender making a revolving credit loan to a borrower reviewed the existing filings. An equipment lessor had filed an informational filing against specific equipment and had included with the filing a copy of the master lease agreement. The master lease agreement as filed was 28 pages of very small type and contained in section 12 an imbedded grant of a security interest by the borrower in all its assets to secure any shortfall in the obligations of the borrower to the equipment lessor in the event of default.

The paralegal identified the filing on the search review chart as covering only specific equipment. There were a significant number of filings against the borrower and a press by the borrower against the lender to close the transaction. Following standard procedures, the associate on the matter only reviewed copies of the filings designated by the paralegal for specific review. Through the standard and customary process, the imbedded senior blanket lien went unnoticed. Fast-forward: the borrower files bankruptcy, the value of the specific equipment is insufficient to repay the borrower’s obligations to the equipment lessor for the discounted present value of the lease payment stream due on default under the master equipment lease, and the working capital lender is primed. End of story; law firm writes check to lender in the amount of the payment from the estate to the equipment lessor in excess of the value of the equipment.

Risk in Preparing and Filing Financing Statements

The next side of the exposure to the lender’s law firm, and again at the least profitable billing point, is the preparation and filing of the lender’s financing statements. Although many assume that this function is not complicated and presents little or no risk to the law firm, the truth is that, again, there is significant risk of mistake, especially under Revised Article 9. Sometimes it is the simplest of tasks that get overlooked. For example, under Revised Article 9 the financing statement must use the exact registered name of the debtor, if one exists. An incorrect name makes the financing statement ineffective if a standard search does not find it. This search logic standard for the accuracy of the name of the debtor is a more rigorous standard than the “seriously misleading” standard under Former Article 9. Although, to many, the preparation and filing of a financing statement may seem to be a ministerial function, this is a mistaken belief. I would submit that most of the preparation and filing problems never reach the light of day, as lawyers settle with their clients over loss of perfection or priority as a result of law firm error. However, not all problems avoid the light of day, as we discuss shortly.

Therefore, from the perspective of the lender’s counsel, the greatest areas of potential malpractice exposure is the review of existing financing statement filings against the borrower and the preparation and filing of the lender’s financing statements. Neither of these areas are significant profit margin service centers. The significant profit potential in a loan transaction for lender’s counsel is in the preparation and negotiation of the loan and security agreements, service areas requiring mid-level and senior attorney attention, and service areas over which there is little malpractice exposure. When the borrower files bankruptcy, very seldom will there be a debate over the complex affirmative, negative and financial covenants in the loan agreement that required hours of counsel time to negotiate and draft. The debate with the trustee or creditors’ committee will be over the perfection of the senior lender’s security interest. Given the expanded scope of Revised Article 9, the risk of malpractice increases.

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Message From the Chair: Uniform Commercial Code Committee

by Linda J. Rusch
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I hope that you are planning to join us at the ABA Business Law Section Spring Meeting in Los Angeles from April 3 to April 6, 2003. We have an amazing number of interesting programs that we are sponsoring or co-sponsoring in addition to a full slate of subcommittee, task force and working group meetings.

On Thursday April 3, 2003, we are sponsoring a UCC Committee Forum from 3-4 p.m. titled: “Significant UCC Cases: What the Courts Have Been Doing While We Have Been Busy with the UCC Revision.” We are also co-sponsoring a Business Law Education Committee Forum from 2:30 to 4 p.m. titled “Training Lawyers and Law Students How to Do Deals.”

On Friday April 4, 2003, we are sponsoring two programs. The first is from 8 to 10 a.m. and titled “Revised Article 9—Questions from the Perplexed: Common Drafting Issues.” The second program is from 2:30 to 4:30 p.m. and titled “Even if You are a Real Estate/ Securities/ Corporate/ Emerging Company/ Finance Lawyer, What Every Lawyer Needs to Know About Article 8.”

On Saturday April 5, 2003, we are co-sponsoring two programs. The first is from 10:30 to 12:30 p.m. and is the annual presentation of “Commercial Law Developments.” The second program is from 2:30 to 4:30 and titled “The Bankruptcy Code and Revised Article 9: Will the Marriage Last? A Policy Discussion.”

In addition to these very interesting programs, each substantive subcommittee and task force will be holding meetings at the Spring Meeting to discuss current projects or legal issues. The UCC Committee has the following substantive Subcommittees: Subcommitteee on Scope, Subcommittee on Article 1, Subcommittee on Sales of Goods, Subcommittee on Leasing, Subcommittee on Payments, Subcommittee on Letters of Credit, Subcommittee on Article 7, Subcommittee on Investment Securities, Subcommittee on Secured Transactions, Subcommittee on International Commercial Law, Subcommittee on UCC Litigation, Subcommittee on Information Licensing, Subcommittee on Globalization of Commercial Law, and the Joint Subcommittee on Electronic Financial Assets. The UCC Committee also has the following substantive task forces or working groups: Task Force on Simplification, Task Force on Consumer Involvement, Task Force on State Certificate of Title Laws, Task Force on Article 9 Forms Book, Joint Working Group on Electronic Contracting and Joint Working Group on the Transferability of Electronic Financial Assets. The UCC Committee also has a number of administrative subcommittees or appointments to assist in the task of running the Committee: Subcommittee on Meetings and Programs, Internet Coordinator, Subcommittee on Membership, Subcommittee on Publications, Annual Survey, Commercial Law Newsletter, Pro Bono Liaison, Liaison to the Committee on Diversity, Liaison to Business Law Today, and Liaison to CFS Committee. If you are a commercial lawyer, there is a place for you in the UCC Committee and opportunities to participate either in discussion of the substantive law issues or in the work of running the committee.

I look forward to seeing you at the Spring Meeting.
**UPCOMING SPRING MEETING**

The Article 1 Subcommittee will meet on Friday, April 4, from 11:00 to 12:00, during the spring meeting of the ABA Section of Business Law in Los Angeles. The meeting will start with an update and legislative status report. Articles 2 and 2A will be presented for approval to the ALI at its May meeting in Chicago. To some extent, the enactment process for Article 1 could be affected by what happens at the ALI meeting. Presumably, it would be more efficient to present Articles 1, 2 and 2A to state legislatures as a package. The Subcommittee meeting will consider various strategies for enactment depending on the outcome of the ALI meeting.

**PROJECTS**

The Subcommittee has been approached by two different publications for articles on Article 1. We will discuss topics and articles that might be authored or co-authored by Subcommittee members.

We will discuss how to organize and produce useful, informative educational materials, as well as educational programs to help educate the bar about the changes in Article 1.

The Subcommittee will focus on the enactment process and how we might participate once this process begins in earnest, including preparing a Practitioner’s Guide to Article 1. One issue to be considered for the Practitioner’s Guide is that Revised Article 1 may require changes to existing forms (e.g. taking into account the new definition of good faith and the transfer to Article 1 of the rules on course of performance and waiver).

Please join us to consider these various issues and strategies at the April 4 meeting.

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**Subcommittee on Sale of Goods**

With the final approval of the proposed amendments to Article 2 by NCCUSL and ALI expected later this spring, the Subcommittee will focus its work on supporting the effort to enact the amendments. We solicit the participation of membership of the Subcommittee and others in preparation of articles analyzing the amendments, development of materials that can be used to assist in the approval process and presenting programs regarding changes in the law. Those interested in participating in the project are encouraged to contact C. Robert Beattie, Chair of the Subcommittee, at RBBeattie@oppenheimer.com with their ideas and suggestions. The Subcommittee will work on preparing an action plan when it meets during the Spring Meeting of the Business Law Section in Los Angeles on Friday, April 4, at 2:00 p.m.

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**NOTE:** This newsletter is published by the Uniform Commercial Code Committee and the Commercial Financial Services Committee of the American Bar Association’s Section of Business Law. The views expressed are the views of the authors only, and are not necessarily those of the ABA, the Section or either Committee. Please contact Katherine S. Allen, Stites & Harbison PLLC, 424 Church Street Suite 1800, Nashville, TN 37219, katherine.allen@stites.com, (615) 782-2205 or Kathleen J. Hopkins, Real Property Law Group PLLC, 1218 Third Avenue Suite 1900, Seattle, WA 98101, khopkins@rp-lawgroup.com, (202) 625-0404 with any comments or suggestions.
Subcommittee on Payments

At the Payments Subcommittee meeting in Washington last summer, panelists and attendees at the meeting discussed emerging trends in the payment systems as indicated in recent surveys, and the panelists ventured to predict future developments in payments law and practice.

The Payments Subcommittee meeting in Los Angeles on Saturday morning, April 5th, will focus on the legal framework of the wholesale wire transfer system. Panelists will discuss:

1. recent cases decided under UCC Article 4A and how they may be expected to affect banking practices;
2. the application to wire transfers of requirements under law enforcement legislation and regulations (BSA, FATF, USA Patriot Act); and
3. current practices in the drafting and negotiation of funds transfer agreements and how such practices may be influenced through the Subcommittee’s project to revise the Model Funds Transfer Services Agreement.

Subcommittee on Investment Securities

First, please join me in welcoming Penny Christophorou of Clearly Gottlieb (pchristophorou@cgsh.com) as the new vice chair of the Investment Securities Subcommittee. Penny will be chairing a program at the Spring Meeting in Los Angeles – “Even If You Are a Real Estate/Securities/Corporate/Partnership/Emerging Company/Finance Lawyer: What Every Lawyer Needs to Know about UCC Article 8”. The panel will include Howard Darmstadter, Allan Donn, Sandy Rocks, Lynn Soukup and Bob Wittie, and will cover the applicability of Article 8 to a variety of transactions (including financings and securities offerings) and related opinions. The Investment Securities Subcommittee meeting is scheduled for Friday, April 4 at 11:00 a.m., and we will discuss taking a security interest in dividends separate from the related security. Suggestions for topics for future subcommittee meetings and programs are always welcome.

Please notify both the ABA and the editors if you have any changes or corrections.

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The Commercial Financial Services Committee (CFSC) last met on 6 November 2002 in Atlanta preceding the Commercial Finance Association Convention. Defying recent downward trends in bar attendance, we had a huge (overflow) turnout. Perhaps it was the great programs put together by Chris Rockers, Jeff Rosenthal and Jim Prendergast that included presentations on Revised Article 9 sales and foreclosures, ethical decision-making in commercial transactions, and multijurisdictional practice. Or, perhaps it was the excellent “Southern buffet” (which really was quite good). In any event, I was gratified by the turnout and apologize to those who had to wait in line or who endured similar ignominies. We appreciate your attendance!

We are very much looking forward to the Spring Meeting in Century City this April 3-6. A great schedule is planned, including the usual complement of substance-packed subcommittee meetings, some exciting programs and a committee forum. The committee forum, at 11 am on Friday morning, will be moderated by Bob Zadek and will feature prominent academicians and practitioners discussing non-UCC things that commercial lawyers should know, stuff like the law of contracts, agency, torts, etc.. One of our CLE programs, at 2:30 pm on Friday afternoon, will explore the new Aircraft Protocol to the UNIDROIT Convention on Mobile Goods, which should attract a broad cross-over audience including members of the Paris Bar Association meeting in conjunction with the ABA. That’s Paris, France, not Paris, Kentucky or Paris, Texas. Our other CLE program will feature Steve Weise and me taking our usual romp through the annals of commercial law and lore. We are also co-sponsoring three other programs – one Thursday afternoon on how to educate young transactional lawyers, one Friday morning on “perplexing” Revised Article 9 documentation issues, and one Saturday afternoon on the uneasy balance between commercial and bankruptcy law these days. This is going to be a great spring meeting with lots of content and networking opportunities. Do not miss it.

Our joint committee dinner at the Spring Meeting in Los Angeles will meet or exceed our customary standard of excellence. Dinner will be at the Jonathan Beach Club in Santa Monica immediately following the Section Reception and will include a delectable selection of seafood, non-seafood and vegetables to please all palates, at one of Southern California’s premier beachfront locations. I’ve been a member for twenty years and I promise you that the food, service and ambiance will all be excellent. If you so desire, you will be able to stroll along the beach and wiggle your toes in the sand (or the ocean), as the club fronts directly on the best part of the beach literally only steps away from the indoor Catalina Room, in which we will be dining. (Evenings can be a bit chilly – bring a jacket or sweater if you plan to stroll outdoors.) Door-to-door bus transportation will be included, and the trip is less than 30 minutes each way. Buses will leave the hotel at 7:30 pm after the reception and will return in shifts after dinner. The ticket price of $100 includes bus transportation, a full buffet, and red and white wine, beer, tea, coffee, water with or without bubbles and soft drinks. You will receive by email and snail mail a sign-up form. Please return it promptly and don’t miss what will be a great event.

We have lots of other exciting stuff going on within CFSC. We
Securitization is a multi-trillion dollar market in the US, and is rapidly becoming a significant source of capital in Canada, Europe, Asia, Australia and South America. This year, for the first time, more funds will be raised through securitization in the US capital markets than through issues of straight corporate debt.

This important area of commercial finance is currently undergoing momentous changes and unprecedented challenges from all directions – from legislative initiatives that the Economist warned could undermine the legal infrastructure of securitization, to accounting changes poised to add billions of dollars to banks’ balance sheets, to Enron-inspired attacks on the use of “special purpose vehicles”.

The Securitization and Derivatives Subcommittee was recently formed to focus on the legal and business aspects of securitization and the use of derivatives in structured finance transactions. Members have been providing each other with advice on difficult opinion issues, as well as information on significant developments in this area.

I extend to all members of the CFS Committee a warm invitation to join the Securitization and Derivatives Subcommittee. Our programs, discussion groups, and inter-meeting communications will help keep you informed about an area of law that impacts all of our clients – those that need financing as well as those that provide it. To join simply email me (martin.fingerhut@blakes.com) or our vice-chair Larry Flick (flick@blankrome.com).

Our inaugural meeting will take place at 3 pm on Friday, April 4th at the ABA’s Spring meeting in LA. I look forward to seeing you there.

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CHECK THIS OUT!

Go to the UCC/CFS Joint Website at www.abanet.org/buslaw/cfs-ucc/home.html and click on (Commercial Finance) Master Calendar
Real Estate Subcommittee

The Real Estate Finance Subcommittee is pleased to announce that we will be having two distinguished speakers at the Spring Meeting of the Business Law Section in Los Angeles. Our speakers will be Nancy Little, Esq. of McGuire Woods, Richmond, VA and Suzanne McElvea of Price Waterhouse Coopers, Dallas TX. Their topic is "Off-Balance Sheet Financing Update: Restructuring and Financing under the new FASB Rules". These new rules on consolidation and the disclosure and recognition of guarantees will significantly affect impact financing of real estate assets and may require restructuring or consolidation of certain transactions and may affect credit ratings. We are expecting a large turnout for this timely and informative presentation.

Loan Workouts Subcommittee

Can’t We All Get Along? -- Managing the New Dysfunction in Workouts of Syndicated Credits. That is the topic of our meeting in Los Angeles at the Spring Meeting in April. One of the continually challenging developments in syndicated and participated credit workouts is the tension and "infighting" that can occur between members of the lending group. This tension is particularly apparent between the agent and a participant holding a small amount of the debt. Often, the agent will want to restructure and workout the credit and the small participant will want to get paid or obtain better voting rights. These tensions make the workout more difficult and are often picked up on by the borrower who tries to use the situation to its advantage. Agents are increasingly being viewed as the "deep pocket", not by the borrower, but by the other lenders. Other issues in these credits involve: dealing with defaulting participants and the funding agent; what is "gross negligence and willful misconduct" for agent activity; trading claims and when is it "unreasonable" for an agent to withhold consent; lenders holding different positions, including equity positions; hedges and any duties to disclose; swap breakage fees for some lenders but not all; agent’s duties to disclose information to participants; and whether the typical agent disclaimer of liability language does protect the agent. We have a sophisticated panel who will address these issues. The discussion will be moderated Vice-Chair Caroline Galanty (Assistant General Counsel for Bank of America), and the panel will consist of Eric Sieke (Senior Counsel for Bank of America), Jennifer Hagle (Partner at Sidley Austin Brown & Wood LLP), and Lawrence Peitzman (Partner at Peitzman, Glassman, Weg & Kempinsky LLP). The meeting will be held at 2:30 p.m. on April 3rd. See you there!
International Financial Services Subcommittee

At the ABA Annual Meeting in Washington, D.C. in August the Subcommittee held a joint meeting not only with our usual partner, the International Commercial Law Subcommittee of the UCC Committee, but also with our own Subcommittee on Secured Lending and the UCC Subcommittee on Secured Transactions. As expected, attendance for the joint meeting was quite good. Of particular interest to our International members, Ed Smith of Bingham McCutchen LLP reviewed conventions and model laws of interest to the commercial lawyer practicing in the U.S (and elsewhere). Our co-chair, Marcy Cohen, gave a summary of the amendments to the Foreign Sovereign Immunities Act being presented by the Section of International Law to the House of Delegates for approval. Despite our efforts against such approval, or at minimum for additional review, approval was granted.

Our next meeting is scheduled during the Business Law Section’s Spring Meeting in Los Angeles, April 3-7, 2003. In keeping with prior sessions, this will be a joint meeting with the International Commercial Law Subcommittee of the UCC Committee and will be held in their time slot of 10:30 to 12:00 noon on Friday, April 4th. Please consult the Meeting Agenda for the exact location. In addition to general business matters and an update of the status of pending international agreements and conventions, we are pleased to have a guest speaker from the National Law Center of Inter-American Free Trade (NLCIFT) to discuss the current status of secured lending in Mexico as a result of the revisions to the commercial code.

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Lender Liability Subcommittee

The Lender Liability subcommittee is looking forward to its meeting in Los Angeles where we will be hosting a program entitled: Lending to Corporate Insiders in Light of Section 402 of the Sarbanes-Oxley Act of 2002. The panel will be made up of Jeffrey R. Capwell with Mcguire Woods LLP, Mark B. Hillis with Bryan Cave and Gerald L. Blanchard, Associate General Counsel with Bank of America. Section 402 prohibits all public and certain non-public companies from extending or arranging for credit in the form of personal loans to directors and executive officers. The panel will examine legal and practical issues involved in trying to comply with the new section including dealing with existing credits in the workout environment.

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CFS Secured Lending Subcommittee/ UCC Secured Transactions Subcommittee

At the annual meeting in Washington, D.C., the UCC Secured Transactions Subcommittee and the CFS Secured Lending Subcommittee joined with the international law subcommittees for an eye-opening discussion by the inimitable Ed Smith on the developing international conventions. The presentation was designed to inform business lawyers what we all need to know, as international transactions become a growing part of our daily practices. Changing focus from the international treaties to the nuts and bolts of Article 9, Sam Rubenstein shared the insider’s perspective with a presentation on the practical aspects of exercising strict foreclosure on an operating business. Leianne Crittenden and Sandra Rocks then led a discussion on current issues in true sale opinions, including the burgeoning practice of requiring these difficult opinions in non-securitization transactions.

As always, we welcome new ideas from our membership for future presentations of interest.

We are now looking forward to our joint meeting in Los Angeles in April, at which we will again tackle timely and important topical subjects. Bruce Shepherd and Meredith Jackson will share their perspective on what it takes to build Las Vegas - financing the mega-casino and other gaming facilities (this time, from the same side of the table). Bob Eisenbach and Jeff Reisner will interpret the U.S. Ninth Circuit Court of Appeals' decision in Aerocon and its effect on the financing of copyrights and copyrightable material, from the perspective of bankruptcy counsel. Bill Veatch and Paul Schmidt will educate us on the special issues relating to the financing of service fees in an economy where manufacturers and software companies are turning to service fees as a growing source of revenue. We anticipate a lively meeting and hope to see you there!

Creditors’ Rights Subcommittee

The Creditors Rights Subcommittee will be meeting jointly with the Bankruptcy Litigation Subcommittee on Thursday, April 3, 2003 at 1:30 pm at the Spring Business Section conference in Los Angeles. Phil Warden and Paul Singerman will be delivering presentations on recent cases and issues of interest. The subcommittees request your participation in what have traditionally been very interactive meetings addressing issues of concern to those whose practices include litigation of debtor-creditor matters. The current economic climate is finding this practice area to be busy and dynamic and we welcome your involvement.
We are looking forward to another interesting and lively discussion in Los Angeles. The IP Financing Subcommittee meeting (Thursday April 3 from 10:30 to noon in the Century Plaza, Olympic II Plaza Level) will hold a roundtable discussion on two topics. The first segment will cover the recent Aercon case (regarding security interests in unregistered copyrights), with Ken Klee of UCLA discussing bankruptcy aspects and Tom Ward of University of Maine discussing IP aspects, along with Shawn Christiansen of Buchalter, who argued the successful appeal, discussing the litigation aspects of the case. In addition, Bill Veatch of Cooley Godward and Paul Schmitt of JP Morgan Leasing have agreed to do an in-depth session on financing of consulting and implementation costs involved in IP transactions. We hope we will see you at the meeting!

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(Continued from page 3) revised Article 9 and the additional categories of collateral now subject to encumbrance by an Article 9 security interest, coupled with the complexity of the Transition Rules and the increased probability of loss of perfection, challenges to the lien position of secured creditors should significantly increase under Revised Article 9 for at least the five year transition period.

In summary, although lender’s counsel has all the malpractice exposure for loss of its client’s first priority position, the law firm is not adequately charging for the inherent risk, and typically is placing the greatest burden to control the risk on the least compensated and prepared component of the legal delivery system. Perhaps to offset this risk, or perhaps to involve the legal party with the supposed greater knowledge concerning the attachment, perfection and priority of the security interest, borrower’s counsel is usually asked for a perfection and priority opinion concerning the security interest perfected through the filing of the financing statements prepared by lender’s counsel.

Risk in Reliance on Legal Opinions

Over the years competent counsel have refused to provide priority opinions, except in specialized transactions such as mezzanine lending and securitization and with respect to certificated securities. This is the result of a number of different factors at work. The first is the “Golden Rule.” This rule provides that a lawyer should not request an opinion from another lawyer in circumstances where the requesting lawyer would not be willing to provide a similar opinion. Counsel to secured creditors will not provide priority opinions, and therefore they should not ask for such opinions.

The other principal factor in the demise of priority opinions is the inherent cost and complexity of a priority legal opinion. As UCC practitioners recognize, “certain opinions (especially priority opinions) may be costly or cumbersome to give because of the extensive qualifications which must be drafted and the due diligence review which must be undertaken.” Report Regarding Legal Opinions in Personal Property Transactions, by the Uniform Commercial Code Committee of the Business Law Section

Even if lender’s counsel can persuade borrower’s counsel to provide a priority opinion, the opinion may not provide the kind of assurance that lender’s counsel wants:

“Although other lawyers may provide some form of priority opinion, the opinion may be significantly qualified as to the types of collateral and competing interests covered by the opinion. As a result, a well-drafted opinion will often contain qualifications and assumptions regarding so many items that the substantive meaning of the opinion is very slight or is incomprehensible to anyone who is not a specialist in personal property transactions. When an opinion becomes so qualified as not to be understandable to most readers, the motivating purpose of the opinion (i.e., to provide assurance to the secured party) is often lost. On the other hand, once the lawyer begins to list all the qualifications and assumptions to an opinion, the possibility of missing one or more possible issues is present. Consequently, priority opinions may be, on the one hand, uninformative because they tell the reader nothing or very little or, on the other hand, wrong or misleading because they fail to describe all exceptions. A secured party should weigh the difficulties and costs associated with the lawyer providing a broad priority opinion against the marginal benefits arising from such an opinion.” UCC Opinion Report.

So, even if the secured lender and its counsel can force borrower’s counsel to provide a priority opinion, the resulting opinion is severely limited in its scope because, as is stated throughout this article, lawyers are risk-adverse and are not being compensated to provide insurance coverage to the lender. UCC insurance is insurance and, as a result, is broader in its coverage than a legal opinion.

Risk in Reliance on Representations and Warranties

In lower dollar transactions without significant or any lawyer involvement, the lender usually is relying completely on the representations and warranties of the borrower. This is something like letting the fox guard the henhouse. This approach may work fine if the borrower is extremely creditworthy and collateral is being taken in “an abundance of caution.” Relying solely on the representations and warranties of the borrower makes less sense, however, where the borrower is not of stellar creditworthiness and/or the ability to proceed against the collateral is the lender’s primary or even secondary exit strategy.

This issue is not limited, however, to the lower dollar value loan transactions. Given the limited utility of borrower’s counsel’s legal opinions, as discussed above, certain rating agencies have concluded that paying for such opinions is not cost effective. Instead, in many securitization transactions, the agencies will rely on the representations and warranties of the borrower. As stated by Dina Moskowitz, Esq, on the Standard & Poor’s website, www.standardandpoors.com:

“Given the limited scope of the security interest opinions typically delivered in structured finance transactions..., and in light of the revisions to Article 9 becoming effective beginning July 1, 2001, Standard & Poor’s has concluded that these opinions will not add significant value to the structured finance rating process for many types of assets, including, among others, credit card receivables, mortgage loans, equipment leases, and automobile loans/leases.”

This reliance is justified in part by the quality of the players involved. However, the quality of players may change over time; Enron and WorldCom woke us up to that fact.

Conclusion—Part 1.

In conclusion, as to objections one and two, if the transaction is of significant size, the UCG insurance can cost-justify itself (at least for lender’s counsel) by removing from lender and lender’s (Continued on page 14)
counsel the high risk and low profit work of reviewing UCC search reports for prior liens, and preparing and filing financing statements. Lender’s lawyers may be reluctant to give up this part of the legal fees they charge, but should instead appreciate the opportunity to reduce the risk levels for both themselves and their clients. Clients will not appreciate counsel who clutch legal work when there is a better and more cost-effective alternative. Over time, the use of UCC insurance should not appreciably reduce the law firm’s income. In fact, the client might send more work to the lawyer upon realizing that the lawyer does indeed have the client’s best interests in mind. The lawyer also ought to love UCC insurance because it off-loads to the insurance company the high risk/low profit work. Malpractice insurance carriers should also love UCC insurance for the same reason.

Replacing such risky but low-margin legal work with UCC insurance is the first obvious economic justification for UCC insurance. The second is the outsourcing that off-loads to the insurance carrier the clerical functions of the preparation, filing and tracking of financing statements. We have discussed above the legal exposure in doing these functions. What we consider here is the time savings from such outsourcing and the freeing up of employee time to do more productive and less legally risky functions. The net gain will either accrue to the law firm for the larger dollar transactions that employ outside counsel, or to the lender. Someone is performing these functions now and there is attendant cost, or risk, to someone. This cost is absorbed by the premium charged for the insurance. Objections one and two above are effectively two sides of the same coin.

Stay tuned–Our next installment will address the third objection.

* Mr. Prendergast is Senior Counsel of The First American Corporation’s UCC Division which, along with the other major land title companies, markets UCC insurance of the type described in this article.

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Martin J. (Marty) Aronstein

I am sad to announce that Martin J. (Marty) Aronstein, long an active member of the UCC committee and former chair of the Article 8 subcommittee, has passed away. Marty was a Professor of Law Emeritus at Penn; he retired after the 85-86 academic year, the year before I arrived. He was the reporter on the 1977 Article 8 amendments and was very active in the committee in the 80s and 90s. He worked on comments to the Trades regulations, the revisions to Article 8 (1994), and was a member of the SECs Market Transactions Advisory Committee in the mid-90s.

— Chuck Mooney
ABA Business Law Section Publications

**Forms Under Revised Article 9**, by the Uniform Commercial Code Committee, ABA Section of Business Law.

Simplify documentation of secured transactions with this all-new time-saver. Combining the most useful features of traditional forms collections and analytical references, this handy book collects forms prepared by UCC Committee experts and comes with its own CD-ROM. Other special features include a summary of Revised Article 9 terms, incisive commentary for each form, annotations with citations to the new UCC rules, comparisons with prior law, discussions of “best practices” and a thumb-tab index. ($54.95 for BLS Members; $69.95 for others. Product Code 5070394.)


This is no ordinary, dry-as-dust legal writing manual. Howard Darmstadter, award-winning columnist for *Business Law Today*, offers a lively collection of his own musings, reflections, suggestions, anecdotes, and witticisms that will entertain you as it teaches you how to modernize your legal documents. Written by a business lawyer for business lawyers, this enjoyable guide covers the basics of legal drafting as well as specific types of documents, such as agreements, securities prospectuses, and promissory notes. It also addresses the use of boilerplate, examples, and mathematical formulas. Unique among drafting manuals, *Hereof, Thereof, and Everywhereof* includes a chapter on formatting a document — how good choices for typeface and size, line length, and paragraphing can enhance document readability. ($39.95. Product Code 5070393.)

**The NEW Article 9, Second Edition**, edited by Corinne Cooper; Steven O. Weise and Edwin E. Smith, contributing authors.

This handy guide provides a clear, in-depth explanation of Revised UCC Article 9, including the full 1999 text (as modified in January 2000) and Official Comments along with the complete text of former Article 9 (1995) for comparison. This book has all you need, including a plain-English overview of Revised Article 9, a checklist of issues, a detailed analysis of the transition provisions, charts comparing significant provisions of former and Revised Article 9, and a comprehensive index. ($39.95 for 1-25 copies; $29.95 for 26-50 copies; $23.95 for 51 or more copies. Product Code 5070360)

**The Default Provisions of Revised Article 9**, by Timothy R. Zinnecker

This guide examines each of the 28 default provisions in Revised Article 9, providing comparative analysis of current and revised law, offering drafting advice when appropriate, and discussing perceived statutory weaknesses. ($29.95 for 1-9 copies; $26.95 for 10 or more copies. Product Code 5070350)

**The ABCs of the UCC**, Series edited by Amelia Boss

These primers are written for both practitioners and students. Each book avoids footnotes and convoluted discussions and explains just the basic UCC concepts and operation of the Code. ($24.95 each for BLS members; $14.95 for students.)

- **Article 1: General Provisions**, by Fred H. Miller and Kimberly J. Cilke (Product Code 5070306)
- **Article 2: Sales**, by Linda J. Rusch and Henry D. Gabriel (Product Code 5070312)
- **Article 2A: Leases**, by Amelia H. Boss and Stephen T. Whelan (Product Code 5070307)
- **Article 3: Negotiable Instruments and Article 4: Bank Deposits and Collections**, by Stephen C. Veltri (Product Code 5070308)
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email - service @abanet.org or visit the website at www.ababooks.org
## UNIFORM STATE LAWS SCORECARD

### 50 State Survey of Adoptions of Revised Official Text of the UCC\(^1\), UETA & UCITA

**AS of September 3, 2002**

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Please note that the Enactment Date does not necessarily reflect the effective date. Please refer to the applicable statute for the relevant effective date.

Our thanks to John McCabe and Katie Robinson at the National Conference of Commissioners ("NCCUSL") on Uniform State Laws for their help in compiling the information above. These revisions are based on information provided by NCCUSL available as of March 3, 2003.

1. In addition to enactments noted below, all states have adopted the 1995 Official Text of Article 5 of the UCC, other than Puerto Rico (no action) and Wisconsin (no action). Furthermore, all states have adopted the 1994 Official Text of Article 8 of the UCC and the 1998 Official Text of Article 9 of the UCC other than Puerto Rico (no action).
2. South Dakota has adopted only 1987 Official Text without the 1990 Amendments.
3. New York and South Carolina are the only states that still have the 1951 version of Articles 3 & 4.
4. States which have repealed Article 6 are identified by indicating "Repeal" next to the state name; states adopting the revisions suggested in Alternative B to the 1989 Official Text are identified by indicating "Revise" next to the state name.
5. New York has adopted the Electronic Signature and Records Act.
6. In addition to the enactments noted, Puerto Rico has only adopted the following Articles: the 1995 version of Article 1, Article 4A, the 1978 version of Article 8, the original versions of Article 5 and Article 7, and the 1972 version of Article 9.
UCC Scorecard - Revisions

ARTICLE 1 – GENERAL PROVISIONS
Final Version: May, 2001
Status: Approved at ALI May, 2001 meeting and at 2001 NCCUSL Annual Meeting.
UCC Committee Contact:
David Snyder (216) 687-2319
Margaret Moses (312) 915-6430

ARTICLE 2 – SALES
Latest Draft: October, 2002
Status: Approved at NCCUSL annual meeting 2002. Up for final approval at ALI annual meeting in May 2003.
UCC Committee Contact:
Rob Beattie (612) 607-7000

ARTICLE 2A – LEASES
Latest Draft: October, 2002
Status: Approved at NCCUSL annual meeting 2002. Up for final approval at ALI annual meeting in May 2003.
UCC Committee Contact:
Larry Flick (215) 569-5556
Ed Huddleson (202) 333-1360

ARTICLE 3 – NEGOTIABLE INSTRUMENTS
Latest Draft: November, 2002
Status: Approved by ALI at annual meeting in May 2002 and NCCUSL at annual meeting in July 2002.
UCC Committee Contact:
Stephanie Heller (212) 720-8198
Paul Turner (310) 472-5802

ARTICLE 4 – BANK DEPOSITS AND COLLECTIONS
Latest Draft: November, 2002
Status: Approved by ALI at annual meeting in May 2002 and NCCUSL at annual meeting in July 2002.
UCC Committee Contact:
Stephanie Heller (212) 720-8198
Paul Turner (310) 472-5802

ARTICLE 7 – WAREHOUSE RECEIPTS, BILLS OF LADING AND OTHER DOCUMENTS OF TITLE
Status: Last drafting committee meeting October 2002. Up for final approval at ALI annual meeting May 2003.
UCC Committee Contact:
William Towle (406) 721-0720.

ARTICLE 9 – SECURED TRANSACTIONS
Latest Amendments December, 2001
Status: Adopted by all 50 states.
UCC Committee Contact:
Steve Weise (213) 244-7831
Pete Carson (415) 693-2000

UNIFORM ELECTRONIC TRANSACTIONS ACT
Final Version: 1999
Status: Adopted by 40 states and pending in several more.
UCC Committee Contact:
Rob Beattie (612) 607-7000
Ben Beard (208) 885-6747

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT
Status: Adopted by 2 states. NCCUSL approved amendments at 2002 annual meeting.
UCC Committee Contact:
Mary Jo Howard Dively (412) 392-2136

UNIFORM CONSUMER LEASES ACT
Latest Draft: May, 2001
Status: Approved at 2001 NCCUSL Annual Meeting. Adopted in one state.
UCC Committee Contact:
Michelle Hughes (757) 499-8800
Section of Business Law Application for Membership

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and follow the instructions.

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