Joint Newsletter of the ABA Section of Business Law Committees on Commercial Financial Services and Uniform Commercial Code

Commercial Law Newsletter

Featured Articles

Applying the Rev. § 9-307(c) "Equivalence Test" to Foreign Filing Systems
Prof. Arnold S. Rosenberg

Increasingly, American lenders and sellers are extending secured credit to debtors located in non-U.S. jurisdictions. If the collateral is located in the U.S., or if there is otherwise a possibility that U.S. law regarding perfection might be applied in case of a dispute, lenders and sellers need to determine which jurisdiction's laws -- the Uniform Commercial Code ("UCC") or the laws of the non-U.S. jurisdiction -- will govern perfection.

Under the "debtor location" rule of Rev. § 9-301, which became effective in most states on July 1, 2001, the laws of the jurisdiction in which the debtor is located govern perfection of security interests in personal property. The debtor is located in a jurisdiction if the debtor is an individual with his or her principal residence there, or if the debtor is an organization with its chief executive office in the jurisdiction.

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The Effect of the 2005 Bankruptcy Code Amendments on Personal Property Secured Transactions in Business Cases
Gabriel R. Safar and Edwin E. Smith

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") was signed into law on April 20, 2005. Its provisions generally became effective on October 17, 2005. The Act makes significant changes to Title 11 of the United States Code (the "Bankruptcy Code") and some related statutes. The following is a brief summary of the effect of the Act on personal property secured transactions in business cases.

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Third Circuit Protects Lender Expectations Regarding Corporate Separateness in Lending to a Group of Affiliated Companies
Patrick J. Potter, Rick B. Antonoff and Andrew J. Love

The Third Circuit’s recent decision in In re Owens Corning offers comfort to lenders who have relied upon the separate existence and credit of affiliated parties in a financing. An important lesson from the court’s decision is that credit underwriting and loan terms should evidence the lenders’ reliance on the separateness of guarantors from the related borrowers.

Many lenders are concerned about the potential impact on a financing transaction of a future bankruptcy of a borrower,
including the risk that in the bankruptcy the creditors of some members of an affiliated group of companies may try to reach the assets of more creditworthy members of the group (even without a direct claim on those assets). This is particularly true where the financing is a securitization or other structured financing relying on the bankruptcy remoteness of a borrower, a financing that relies on structural subordination, or a financing relying on the financial strength of one party to provide credit support for the financial risks associated with lending to a related party.

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Messages from the Chairs

Committee on Commercial Financial Services
Christopher J. Rockers

We are saddened to let you know that on January 8, 2006, Chris Rockers’ wife, Judi passed away following unexpected complications during surgery. All of our thoughts go out to Chris, their six young children and family at this difficult time. The family has suggested that memorial contributions be made to Holt International Children’s Services, Waiting Child Fund, P.O. Box 2880, Eugene, Oregon 97402. If you would like to contact Chris to express your sympathy, his address is Christopher Rockers, c/o Husch & Eppenberger, LLC, 1200 Main, Suite 1700, Kansas City, MO 64105.

November 21, 2005

The Committee on Commercial Financial Services is wrapping up a busy year. Since our last newsletter we have met in conjunction with the Annual Meeting of the ABA in Chicago, and have met at the Annual Convention of the Commercial Finance Association earlier this month in San Diego. We have also been very busy planning for our meetings in Tampa at the 2006 Spring Meeting and in Honolulu for the Annual Meeting of the ABA in August 2006.

At the Annual Meeting in Chicago, we presented, along with Banking Law, Business Bankruptcy and UCC, a jointly sponsored program which addressed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The program was titled “The Practical Impact of the Bankruptcy Reform Act of 2005 for Business, Financial and Transactional Lawyers”, and was moderated by Meredith Jackson of Irell & Manella LLP in Los Angeles. We also presented a Committee Forum titled “Second Lien Financing: Negotiating the “Silent Second” which was chaired by Tony Callobre of Sheppard Mullin in Los Angeles. We had a great turnout and Tony has agreed to chair our new “Syndications and Lender Relations Subcommittee” – more on that later.

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Committee on Uniform Commercial Code
Stephanie Heller

November 22, 2005
I am excited to report that at the 2005 Annual Meeting the UCC Committee presented the first ever UCC Award for Exceptional Service to Fred Miller. This award recognizes exceptional work and sustained service of individuals in the development and advancement of the UCC and commercial law. I am confident that all would agree with the decision of the UCC Committee leadership that Fred Miller’s forty years of service to commercial law and the UCC exemplifies this standard.

The event itself, which took place during the full UCC Committee meeting, was rather informal. This was not without some thought. As I said during the presentation, I think of the UCC Committee as a family and we wanted to make sure that this special event was open to all of our family. After some brief remarks from me, which will be published in the next issue of the Consumer Finance Law Quarterly Report, Fred was gracious enough to share some of his thoughts about the past and future of commercial law. I know I speak for all who were there when I say thank you Fred.

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Committee on Commercial Financial Services: Subcommittee Reports

Subcommittee on Agricultural and Agri-Business Financing
T. Randall Wright, Chair; R. Lawrence Harris, Vice-Chair

Fraud Schemes in the cattle industry and the status of laws restricting corporate ownership of farms were two of the topics when the Agricultural and Agri-Business Financing Subcommittee met in Kansas City in October, 2005, in conjunction with the annual American Agricultural Law Association meetings. The subcommittee presented two panels. The first was entitled "Ponzi Schemes, Check Kites and Other Methods of Off-Balance Sheet Financing", which included discussions of recent cattle fraud cases and the legal issues presented in subsequent bankruptcy cases. Featured on the panel were Honorable Judge Jerry Venter of the Western District of Missouri, Phil Kunkel of Gray, Plant Moody in Minneapolis, and Mark Benedict of Husch and Eppenberger.

The second panel discussed the latest cases challenging anti-corporate farming laws in various Midwestern states. Speaking on that panel were subcommittee vice chairman Larry Harris of the Melchert Hubert Sjodin firm in Minnesota, Harrison Pittman of the National Agricultural Law Center and Mary Hendrickson of the University of Missouri (Columbia).

At the Spring meeting, the likely topic will be determining when the agricultural borrower has "rights in the collateral."

Subcommittee on Aircraft Financing
James D. Tussing, Chair; Michael K. Vernier, Vice-Chair

The Aircraft Financing Subcommittee would like to report that a significant change in U.S. and international aircraft finance law is about to occur with the long awaited implementation of the Cape Town Convention. The Convention was originally approved in a diplomatic convention attended by representatives of sixty-eight countries in Cape Town, South Africa in 2001. It was ratified by
the United States in 2004. With its ratification by an eighth country, Malaysia, on November 2, 2005, it will become effective on March 1, 2006.

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Subcommittee on Intellectual Property Financing
Leianne Crittenden, Co-Chair, Thomas M. Ward, Co-Chair

At the Chicago Annual Meeting, the Intellectual Property Financing Subcommittee followed up on the successful music financing presentation in Nashville with another music-related presentation. In Nashville we discussed how portfolios of songs can serve as collateral for loans. In Chicago, John Rolfe of Boul, Cummings, Conners & Berry in Nashville joined us again, with Mike Olson, President and COO of Compendia Music (as well as an attorney). It was (again) a very interesting presentation, discussing how record companies are financed. It was very interesting look at what sounds like a complex business. Again, this presentation pointed out that while you can provide financing for IP assets, you need to understand the asset characteristics and risks in order to do so. Tom Ward and Leianne Crittenden are planning a presentation concerning Trademarks for the Spring Meeting. Please join us for this presentation, as well as an update on past cases reviewed in our meetings.

Subcommittee on Securitization & Derivatives
Martin Fingerhut, Chair, Teresa Harmon, Vice-Chair

Our subcommittee had an excellent meeting in Chicago in conjunction with the ABA Annual Meeting. Following our regular business meeting, we had a very timely presentation by Rob Hugi of Mayer, Brown, Rowe & Maw LLP on the major features of two recent SEC initiatives that will have a significant impact on all public ABS transactions: (i) Reg AB – which for the first time comprehensively addresses registration, disclosure and reporting requirements for asset-backed securities under the ’33 and ’34 Acts, and (ii) the general reform of the entire securities offering process. Rob also discussed the problems that the new rules were intended to deal with, and whether they were successful in doing so.

Larry Flick, our vice chair since the inception of our subcommittee is stepping down after his appointed three year term. Our thanks to Larry for his assistance during our formative period. I’m delighted to announce that Teresa Harmon, a partner at Sidley Austin Brown & Wood LLP will be our new vice chair and is looking forward to helping us plan a number of informative and interesting meetings and programs in the years to come. We hope to see you in Tampa during the Spring Meeting.

Subcommittee on Surveys of Commercial Law
Brian D Hulse

For several years, the Surveys of Commercial Law Subcommittee has been engaged in a project to prepare a relatively detailed summary of the commercial lending laws of all 50 states plus the District of Columbia and Puerto Rico. A volunteer in each jurisdiction is responsible for preparing that jurisdiction’s survey and each survey follows a uniform format. The surveys cover a variety of topics including personal property lending, real estate
lending, guarantees, state tax and regulatory issues affecting lenders, etc. As of November 1, 2005, surveys for 41 of the 52 jurisdictions have been completed and posted to the Commercial Financial Services Committee's website. They are available to CFSC members by clicking here. Surveys for the remaining jurisdictions are in process and should be posted within the next several months.

Committee on Uniform Commercial Code: Subcommittee Reports

Subcommittee on Leasing
Barry A. Graynor, Chair, Teresa D. Davidson, Vice-Chair

At the 2005 ABA annual meeting, Peter J. Deeb, Malcolm C. Lindquist, and Michael R. Stewart gave a presentation to the Leasing Subcommittee entitled “NorVergence, the Continuing Saga.” NorVergence, Inc., a New Jersey based telecommunications provider, originated over $250 million in Equipment Rental Agreements (“ERA’s”) covering a product it developed called the “Matrix.” NorVergence then sold/assigned the majority of the ERA’s to unrelated third party leasing companies (“Assignees”). In July of 2004, NorVergence ceased operations and became the debtor in a Chapter 7 bankruptcy. The collapse of NorVergence left thousands of business customers without service but still saddled with a continuing obligation to make rental payments on a Matrix of greatly diminished value and utility. The lessees stopped payment and the Assignees began actions to enforce the ERA’s. The Assignees then found themselves defendants in several class actions and the target of investigations commenced by the Attorney Generals of several states.

In May 2005, a Florida circuit court dismissed the Florida Attorney General’s suit against a number of leasing companies who purchased Norvergence leases, holding that the leasing companies had not violated Florida’s laws. Among other things, the court upheld the hell and high water, the waiver of defense, and forum selection clauses. Also in May 2005, an Ohio appellate court was presented with an appeal involving the so-called “floating” forum selection clause used in the NorVergence leases. This clause provides that all legal actions relating to the lease may be brought in such court chosen by the lessor or the lessor’s assignee at its sole option. The appeal was taken by Preferred Capital and it involved 11 trial court decisions which had refused to enforce the clause. The Ohio appellate court dismissed the appeal on the ground that the trial courts’ orders were not final appealable orders, because the cases can be refiled in other states. In June 2005 the U.S. District Court for the Northern District of Ohio issued an opinion (2005 WL 1398549) holding that the floating forum selection clause used in a NorVergence lease with Aetna Maintenance, Inc. was unenforceable because (i) the clause did not identify Ohio as the forum for litigation even though NorVergence knew that the lease would be assigned to Preferred Capital and Preferred Capital would commence any action against Aetna in Ohio and (ii) the forum selection clause was buried in the middle of a paragraph of very small print.

Watch for continuing developments on NorVergence!
Subcommittee on Payments
Paul Stephen Turner, Co-Chair, Stephen Charles Velti, Co-Chair

Thank you to everyone who attended the August 8, 2005, joint meeting of the UCC Subcommittee on Payments and the Banking Law Subcommittee on Payments and Electronic Banking at the ABA’s annual spring meeting in Chicago. The session focused on recent developments in electronic banking products. In a presentation entitled Clash of the Titans Redux: Competing Electronic Payment Products Five Years After the Collapse of the Dot Com Bubble, panelists described how the Olympians—new technologies and business models that five years ago appeared to be the wave of the future—have largely succumbed to the old Titans—regulated financial intermediaries.

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Subcommittee on Investment Securities
Penelope (Penny) Christophorou, Chair, Meredith Jackson, Vice-Chair

At the ABA Annual Meeting in Chicago this year, the UCC Subcommittee on Investment Securities gave a presentation entitled “Deposit Accounts and Securities Accounts As Collateral: Twin Sons of Different Mothers” which analyzed and compared the various UCC provisions relating to securities accounts and deposit accounts.

The Investment Securities Subcommittee will meet on Thursday, April 6, 2006 from 10:00 AM to 11:00 AM at the ABA Section of Business Law Spring meeting in Tampa, Florida. Lynn Soukup of Pillsbury Winthrop Shaw Pittman LLP, Sandy Rocks of Cleary Gottlieb Steen & Hamilton LLP and Meredith Jackson of Irell & Manella LLP have agreed to give their presentation titled “Secured Party Purchase of Collateral at Private Sale – Collateral Customarily Sold on a Recognized Market” which will cover the Burns v. Anderson case and relevant provisions of UCC Article 9.

Please join us in hearing our esteemed speakers and in participating in the lively discussion that will undoubtedly ensue.

Joint Task Force, Working Group and Liaison Reports

Business Law Today Liaison
Kathleen J. Hopkins

As the liaison from the Business Law Today editorial board to both committees, I am reminding members that the magazine is a great way to educate our larger membership in UCC and CFS matters, and do a little marketing to boot. I am pleased to report that the materials from last spring’s CLE on Music Financing (by the CFS Secured Lending / UCC Secured Transactions Subcommittees) will be featured in an upcoming theme issue on the “Business of Fun.” We also have a great article submitted through the CFS Real Estate Financing Subcommittee on Defeasances. I encourage all members to review their files: are there CLE materials which your associates could help morph into short, interesting articles for the magazine? The criteria for articles requires limited prior publication, but ABA CLEs and newsletters and also client advisories, are notable exceptions. Visit the magazine’s website at:
http://www.abanet.org/buslaw/blt/guidelines.html for the complete author guidelines (and feel free to contact me for assistance with the process or to answer your questions).
Keep this in mind when you prepare materials for your subcommittee meetings or CLEs. If you (and/or one or more of your associates) have an idea for a substantive article, you are welcome to contact me directly!

Joint Task Force on Deposit Account Control Agreements
Marshall Grodner, CFS Co-Chair; Marvin Helleson, Banking Law Co-Chair; Ed Smith, UCC Co-Chair; Roberta Torian, CFS Co-Chair; John Pickering, Banking Law Vice-Chair

The Joint Task Force on Deposit Account Control Agreements was established by the Business Law Section to develop a form or forms of UCC Article 9 deposit account control agreements that could be entered into by the parties with no or minimal negotiation. The Task Force is jointly sponsored by the Banking Law, Commercial Financial Services, Consumer Financial Services and Uniform Commercial Code Committees of the Section. It is composed of a number of in-house and transactional lawyers from a broad base of depositary and lending institutions as well as academicians and other interested parties. The Co-Chair from the Commercial Financial Services Committee is Marshall Grodner, and the Co-Chair from the UCC Committee is Ed Smith.

After a number of meetings since it was formed in 2004, the Task Force is nearing completion of a form of a deposit account control agreement for a demand deposit account (without lock box arrangements or a related securities account). The Task Force is also completing a report to be published in The Business Lawyer discussing the progress of the task force and explaining a number of provisions of the form. The Task Force plans to present the form and report at a program at the Section’s 2006 Spring Meeting in Tampa.

The Task Force will shortly be turning its efforts to other forms of deposit account control agreements such as demand deposit accounts with lock box arrangements and blocked and swept accounts.

Anyone interested in joining the Task Force or obtaining a copy of the current draft of the deposit account control agreement form or the Task Force report should feel free to contact Marshall Grodner at mgrodner@mcglinchey.com or Ed Smith at Edwin.Smith@Bingham.com.

Pro Bono Liaison
Kathleen J. Hopkins

As the co-chair of the Section’s Pro Bono Committee and your liaison, I am pleased to report some very wonderful developments in the Section’s pro bono and public service activities. As you may know, our Section has a strong, substantial commitment to providing pro bono to our communities and cultivating opportunities for its members within their practice areas. We are also hiring new staff counsel who will be engaged by the Section and housed in the ABA Center for Pro Bono to work exclusively on Business Pro Bono Projects.

The Pro Bono Committee is presently updating its website http://www.abaprobono.org/businesslaw. Please visit the site for information on one of the Section’s showcase projects: A Business Commitment (ABC). ABC is a project adopted by local and state bar associations, ad hoc groups and law schools around the country to provide community based non-profit organizations...
and micro-entrepreneurs with pro bono business legal advice. We currently have over 30 active projects around the country (and growing); and **on March 30-April 1 2006** at the ABA's Equal Justice Conference in Philadelphia we will be providing a full day of programming for bar leaders and existing ABC project coordinators on how these projects can be set up, grow and succeed.

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**Joint Subcommittee on Secured Transactions**
Leianne S. Crittenden, Chair UCC Secured Transactions Subcommittee, Malcolm C. Lindquist, Chair CFS Secured Lending Subcommittee, Katherine Simpson Allen, Vice-Chair CFS Secured Lending Subcommittee, Pauline Stevens, Vice-Chair UCC Secured Transactions Subcommittee

We had another entertaining presentation in Chicago at the Annual Meeting. We covered a variety of unusual transactions, including lending to State and Local Governments, UCC provisions for the sovereign Indian Nations, and lending arrangements with the Catholic Church. These topics each had their own pitfalls, and were presented by Neil Hertenstein, Principal in the Municipal Sciences Institute, Fred Miller and Jim Hayes, a professor of Canon Law at Western State University. The presentations focused on the unusual aspects and characteristics of these borrowers and the resulting issues that complicate lending arrangements with them. We look forward to seeing you all again at the Spring Meeting.

**UCC Scorecard**

**UNIFORM STATE LAWS SCORECARD**
Survey of Adoptions of Revised Official Text of the UCC
As of October 4, 2005

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Applying the Rev. §9-307(c) “Equivalence Test” to Foreign Filing Systems

By:
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Introduction

Increasingly, American lenders and sellers are extending secured credit to debtors located in non-U.S. jurisdictions. If the collateral is located in the U.S., or if there is otherwise a possibility that U.S. law regarding perfection might be applied in case of a dispute, lenders and sellers need to determine which jurisdiction’s laws – the Uniform Commercial Code (“UCC”) or the laws of the non-U.S. jurisdiction – will govern perfection.

Under the “debtor location” rule of Rev. §9-301, UCC, which became effective in most states on July 1, 2001, the laws of the jurisdiction in which the debtor is located govern perfection of security interests in personal property. The debtor is located in a jurisdiction if the debtor is an individual with his or her principal residence there, or if the debtor is an organization with its chief executive office in the jurisdiction.

Thus, for example, if Bank of America were to make a business loan to a corporation headquartered in Ontario secured by the inventory, equipment and accounts receivable of its operations in the United States, Ontario law would govern perfection of Bank of America’s security interest. Ontario has a Personal Property Security Act resembling pre-Revision Article 9 of the UCC, so to achieve priority over competing secured creditors, Bank of America would have to file a financing statement in accordance with Ontario law.

However, what if the debtor’s country has no system for perfecting security interests, or has a system radically different from the American centralized filing systems, Rev. §9-307(c) establishes an equivalence test? If the laws of the debtor’s country are not substantially equivalent to the Rev. Article 9 filing system, as measured by the criteria set forth in §9-307(c), the debtor is deemed to be located in the District of Columbia. The impact of non-equivalence is that the secured party is excused from compliance with non-U.S. law and may perfect under the laws of the District of Columbia.

Rev. §9-307(c) establishes the following criterion for determining equivalence: a foreign filing, recording or registration is equivalent to Rev. Article 9 if it “generally requires information concerning the existence of a
nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest’s obtaining priority over the rights of a lien creditor with respect to the collateral.”

According to Official Comment 3, the purpose of Rev. §9-307(c) is to obviate the need to comply with foreign laws that “affor[d] no public notice of security interests.” However, Rev. §9-307(c) fails to accomplish that end, and instead routinely results in a multiplicity of efforts to perfect security interests under both foreign and D.C. law whenever a debtor is located in a foreign country. In its present form, Rev. §9-307(c) often yields absurd results, creates pointless and costly hurdles for lenders and sellers, and impedes the smooth functioning of international credit markets and the orderly and timely consummation of cross-border transactions.

The State Bar of California Business Law Section UCC Committee is preparing a report on non-U.S. systems for filing, recording and registering security interests in personal property. The report is expected to provide information about the status of filing, recording and registration systems in several foreign jurisdictions, and may attempt to identify those countries that at the current time, clearly do not satisfy the “equivalence test,” those that clearly do satisfy it, and those that occupy a gray area with respect to the application of Rev. §9-307(c). The report also may recommend changes in Rev. §9-307(c).

However, neither this article, nor the State Bar of California report in process, is intended as an opinion regarding the safety or advisability of extending secured credit to debtors located in any particular country, nor that a secured party can safely achieve priority by registering its interest in the collateral under foreign or Washington, D.C. law. Several caveats must be borne in mind by commercial lawyers in evaluating information about foreign filing, recording and registration systems.

First, a registration system may exist on paper but not be satisfactorily implemented. The state of implementation of a registration system can change over time. Second, if collateral is situated in the foreign country, and enforcement action becomes necessary, it cannot be assumed that a foreign court would recognize the validity or priority of a lien created under American law and perfected by filing in Washington, D.C.

Third, foreign law may not recognize security interests in the type of collateral, or in favor of the type of secured party, at issue in a particular case. Fourth, contractual choice of law clauses may or may not be given effect to alter the law that otherwise would govern perfection of security interests. Different foreign jurisdictions take divergent approaches to the effectiveness of choice of law clauses with respect to perfection.

**Types of Registration Laws**

Foreign laws regarding filing, recording or registration of security interests
tend to fall into four categories: Article 9-type statutes, the Continental European model, the English model, and the Latin American model. Many nations’ laws, however, represent variants of these models or are idiosyncratic.

**Article 9-type statutes.** First, some countries clearly maintain filing, recording or registration systems that satisfy the first test of Rev. §9-307(c) in that they generally make available information concerning the existence of a non-possessory security interest in collateral. A few countries – Canada and New Zealand in particular – have independently chosen to enact Article 9-type statutes. Many countries of Eastern Europe and the former Soviet Union, such as Albania, Bosnia, Romania and Kazakhstan, have enacted Article 9-type statutes at the urging of the European Bank for Reconstruction and Development (“EBRD”) and the World Bank. Some Asian countries, too, such as Indonesia and Taiwan, possess registration systems that bear some resemblance to Article 9; but in Taiwan and certain other Asian countries the application of foreign exchange and lender licensing laws make it difficult or impossible for foreign secured parties to use the registration system. In some countries of Eastern Europe and Central Asia, obtaining access to records kept in registration offices can be problematic due to arbitrary exercise of discretion by local bureaucrats or corruption.

**The Continental European model.** Second, many civil law countries clearly fall short of the requirements of Rev. §9-307(c). Such countries include Austria, Germany and the Netherlands, among many others. They maintain no system for registering security interests in personal property, with limited exceptions for assets titled under special laws and treaties such as ships and patents. In these countries, retention of title and fiduciary transfer of title are typically the methods by which sellers and lenders attempt to secure payment.

Title retention and fiduciary title arrangements prevail in most civilian jurisdictions, particularly in Western and Central Europe, both for doctrinal reasons and the lack of non-judicial enforcement procedures (and the inefficiency of judicial procedures) available to secured parties in case of default. Such arrangements under UCC §2-505 would be limited to retention of a purchase money security interest in goods sold. Unlike the UCC, title retention and fiduciary title arrangements are almost universally upheld in Western and Central Europe against an insolvency trustee, with the exception of Luxembourg, on the theory that the collateral is property of the lender or seller rather than an asset of the bankruptcy estate. Apart from Switzerland, few European countries have a system of filing, recording or registration to publicize title retention and fiduciary title arrangements. It is left to the diligence of a lender to inquire whether the prospective borrower has fully paid the purchase price of any personal property offered as collateral, or repaid any loans that were the subject of a fiduciary title arrangement, and thereby acquired clear title to those assets.

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French law represents a variant of the Continental European model. It superimposes on the model a registered “enterprise charge” (nantissement sur fonds de commerce or fonds artisanal) that is a cross between the American floating lien and the English floating charge. In French law unregistered interests, such as the rights of a seller that has retained title, are enforced and have priority over the rights of a liquidator and other creditors in insolvency. Registration is required to create certain types of fixed charges, but not for what in the U.S. would be purchase money security interests to have priority in insolvency.

The English model. Third, there is a broad group of countries that follow the English system of secured transactions. The English system recognizes the “floating charge,” a security device different in key respects from the American “floating lien” and one which does not neatly fit into the Article 9 framework. In the English system, a registered floating charge – which may be granted only by a company, not an individual – floats on the debtor’s assets but does not attach to them until an event of “crystallization” such as default, insolvency, or levy of execution. Without registration the floating charge cannot come into existence. At the moment of crystallization, the floating charge becomes a fixed charge on whatever assets the debtor owns at that time. Prior to crystallization, however, the debtor is free to grant fixed charges such as chattel mortgages which upon being registered, take priority over the earlier-registered floating charge. In addition, prior to crystallization the debtor may sell property that is subject to the charge and a good faith purchaser will receive the property free of the charge. Finally, prior to crystallization statutory liens may be fixed in the assets of the debtor and they, too, will take priority over the floating charge.

In the English model, security interests may be given by individuals by way of a bill of sale pursuant to Bills of Sale Acts based on the English Bills of Sale Act. Bills of sale may be registered, but rarely are.

The Latin American model. A Model Inter-American Law on Secured Transactions drafted on behalf of the Organization of American States (“OAS”) follows the general lines of Article 9, and may be enacted shortly by Guatemala. However, Latin American laws on secured transactions are based on the civil law system and unregistered title retention and fiduciary title devices are generally enforceable against the interest of a bankruptcy receiver or trustee. To the extent that registrable security devices exist, they are fragmented according to the business of the debtor and the type of lender. Agrarian pledges are governed by different laws than industrial pledges. Financial institutions are permitted to take certain security interests that other lenders cannot. Divergent registration systems with inconsistent rules govern different types of security devices.

Moreover, many registration systems in Latin America are poorly organized and unreliable, and in some cases, not open for public inspection, casting doubt on whether they pass the “generally available” test. Most of these registries were designed for annual or semi-annual updating of business association corporate or societal records. In the interim, a prospective lender
that wishes to find out whether the inventory or the accounts receivable or the sales proceeds of the borrower have been pledged and if so to whom and for approximately how much, the registry could not supply such information. High registration fees also encourage the use of title retention and fiduciary title devices rather than registered security devices.

**Problems in Applying Rev. §9-307(c) to Foreign Filing, Recording and Registration Systems**

**No Clear Bright Line: “Generally Requires” and “Generally Available” Requirements**

Rev. §9-307(c) requires a secured lender or seller to evaluate whether the personal property filing, recording or registration system of the debtor’s country meets certain standards. If foreign law “generally requires” the filing of nonpossessory security interests in personal property to achieve priority over lien creditors, and if the filing system is “generally available” and hence gives adequate public notice of such security interests, then the secured party must perfect in accordance with foreign law. If foreign law does not pass this test, the secured party must perfect under D.C. law.

What the drafters contemplated may have been that a consensus would emerge about the adequacy of different countries’ filing systems so that secured lenders and sellers could, in effect, color-code a map of those countries whose systems passed or did not pass the Rev. §9-307(c) equivalence test – e.g., England yes, Germany no. Reality is not so simple.

**Filing System Limitations as to Types of Debtors or Secured Parties**

For example, a large number of countries, including most Latin American countries, limit registration of nonpossessory security interests to certain types of debtors. A seller selling goods to an industrial or agricultural company located in a country that requires, and permits, registration only if the debtor is an industrial or agricultural company shouldn’t have to worry about whether a purchase money security interest could be registered if the debtor were a services company or an individual. Yet Rev. §9-307(c) forces the lender or seller to worry about these irrelevancies.

Another problem concerns countries such as Taiwan that preclude the use of their registration systems by foreign lenders that are not authorized to make loans in that country, or preclude registration of documents if the loan is denominated in foreign currency. If a country’s registration system satisfies the equivalence test but is effectively closed to foreign lenders, the effect under Rev. §9-307(c) is that it is impossible to perfect a nonpossessory security interest in the personal property of any debtor located in that country.
Uncovered Types of Collateral

The “color-coded map” idea of Rev. §9-307(c) creates another problem. Suppose a country’s registration system for nonpossessory security interests in personal property passes the equivalence test; it “generally requires” filing to achieve priority over a lien creditor and the information in its registration system is “generally available”. That alone would not ensure that a lender or seller could perfect by registering, because there might be particular categories of collateral that are not covered by the registration system. Since the country’s registration system as a whole passes the §9-307(c) equivalence test, registration would be the only way to perfect a security interest. Yet if the proposed collateral is not covered by the country’s registration system, there would be no way at all for the lender or seller to perfect its interest. Rev. §9-307(c) would make a filing in D.C. meaningless if the foreign country’s registration system passes the equivalence test. The country is colored “yes” on the map, yet the answer for the lender or seller that wants to extend credit on collateral not covered by the country’s registration system is “no way.” A lender extending credit on the security of a type of collateral that is covered by the registration system – say, equipment - shouldn’t have to be concerned with whether registration would be required of security interests in other types of collateral, e.g., accounts or general intangibles.

No Deference To Conditional Sales, Fiduciary Title And Constructive Redelivery

Another issue regarding Rev. §9-307(c) ultimately concerns how much deference to give to foreign laws. Many civil law countries, including Austria, Germany and the Netherlands among others, use conditional sales, title retention or transfer and constructive delivery rather than filing and registration systems to perfect what in the United States would be classified as nonpossessory security interests. A German debtor buying equipment under a conditional sale contract, for example, probably would have to permit the seller to label the equipment as property of the seller until the price has been fully paid, and the seller or a fiduciary titleholder would retain the unqualified right to possession of the equipment unless the parties have circumvented this problem by a device such as constructive redelivery to the seller or a lease-to-own arrangement. In contrast, Rev. §9-307(c) accords no deference to these unregistered security devices.

Practical Adequacy of Filing Systems

Yet another concern about Rev. §9-307(c) is that it does not take into account the adequacy of the actual functioning of foreign filing systems, only whether foreign law “generally requires” filing and whether the system is “generally available.” Argentina, for example, has a registration system with broad application on paper, but its registries, though available to the public, are notoriously fragmented and outdated. Are its records “generally available” even
though they will often yield erroneous information? Furthermore, if an American lender were to determine that Argentina fails the equivalence test at present due to these practical inadequacies, and in reliance on that determination files only in Washington, D.C., would the lender’s security interest cease to be perfected if a zealous registrar in Argentina a year later cleans up and updates the registries in his or her part of the country?

Public Access to Filing System
A number of civil law countries such as Hungary that require notarization of security agreements and related documents have established central notarial registers that may be accessible only to notaries, who in such countries are highly trained lawyers. Is the information in these registration systems “generally available” for purposes of Rev. §9-307(c), even though the public is not allowed to inspect them? If the lender or seller has to retain a notary anyway to create and perfect its security interest, it shouldn’t matter whether non-notaries have access to the records.

A further problem is presented by countries such as China where local registries are controlled by functionaries who are given virtually unbridled discretion to determine who will have access to the information contained in the system. Such discretion invites abuse.

What’s a “Lien Creditor”? What’s a “Security Interest”?
There are numerous types of statutory liens, not only in the United States but in many foreign countries. Not all foreign countries treat all lien creditors the same way vis-à-vis registered security interests. If a foreign filing system puts the secured party with a registered interest above some lien creditors but beneath others in priority, does that country’s filing system pass the equivalence test?

Moreover, while bankruptcy trustees generally have the status of a lien creditor under the “Strong-Arm Clause,” 11 U.S.C. §544(a), other countries do not endow bankruptcy trustees with this status, or do not have bankruptcy trustees at all.

Lawyers from civil law countries often have difficulty understanding the concept of a security interest, because it violates the *numerus clausus* of Roman law on which the civil law of property is based. Switzerland has a registration system for fiduciary title and title retention arrangements; most other Continental European countries do not. Are fiduciary title and title retention “security interests” even though foreign laws do not recognize the concept?

The Effect of Foreign Choice of Law Rules
Two foreign filing regimes that almost certainly would be considered to satisfy the equivalence test of Rev. §9-307(c) are the Personal Property Security Acts
(“PPSA’s”) adopted in Canada and New Zealand, which are based on pre-Revision Article 9. However, the PPSA’s, like pre-Revision Article 9, require perfection in accordance with the law of the place where the collateral is located. A New York lender lending to an Ontario corporation on the security of collateral located in New York is directed by Rev. §9-307(c) to file in accordance with Ontario law, yet Ontario law says to file in accordance with New York law. Can the New York lender safely ignore the choice of law provision of the PPSA’s and file only in Ontario – where the filing might be considered ineffective due to the absence of the collateral– and not in Washington, D.C.?

Would the UCC Fail the Rev. §9-307(c) Test?

It is ironic that the drafters thought they were drafting a statute that required lenders and sellers to compare foreign filing systems with the UCC filing system. Again taking Rev. §9-307(c) literally, the Article 9 filing system would not pass its own equivalence test but for the statement in Official Comment 3, second paragraph, that a “jurisdiction that has adopted this Article or an earlier version of this Article” would satisfy the test. Purchase money security interests in consumer goods doubtless represent the largest absolute number, though perhaps not the largest dollar volume, of security interests in the United States, yet the UCC does not require the filing of a financing statement to perfect them. Thus, the UCC cannot be said to “generally require” filing to perfect security interests, unless the universe of security interests is restricted to non-consumer transactions. Rev. §9-307(c), however, contains no such restriction.
The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”) was signed into law on April 20, 2005. Its provisions generally became effective on October 17, 2005. The Act makes significant changes to Title 11 of the United States Code (the “Bankruptcy Code”) and some related statutes. The following is a brief summary of the effect of the Act on personal property secured transactions in business cases.

I. PROVISIONS OF THE ACT THAT DIRECTLY IMPACT SECURED TRANSACTIONS

Reclamation of Goods. Revised § 546(c) provides that, subject to the rights of secured parties, a seller of goods has a right to reclaim goods received by the debtor within 45 days before the commencement of the case. The seller must provide written notice of intent to reclaim the goods not later than 45 days after the date of the debtor’s receipt of the goods, or not later than 20 days after the date of commencement of the case if the 45 day period expires after the commencement of the case. The revised section may create a federal right of reclamation in bankruptcy, but some commentators have suggested that it merely expands the time period for exercising state law reclamation rights under UCC § 2-702. Of course, if the reclamation notice is provided after the goods have been sold or processed, the seller will have no reclamation right. Moreover, even if the goods have not yet been sold or processed, the seller’s reclamation right will be subject to the rights of a secured party having a security interest in the goods. Accordingly, the reclamation right will be meaningful only if the secured party is otherwise fully secured. Arguably, a reclaiming seller may seek a valuation of the secured party’s other collateral in order to exercise its reclamation right. However, given that bankruptcy courts, debtors and other creditors are often reluctant to force valuations too early in a case, it is possible that a reclaiming seller may be offered an administrative claim or junior lien on other collateral contingent on it being later determined that the secured party was otherwise fully secured. See also the discussion of new § 503(b)(9) below.

Preference Actions. The Act contains significant amendments to § 547 that make it more difficult for trustees to avoid transfers to secured parties as preferences. Among those amendments are the following:

- Transfers to Non-Insiders for the Benefit of Insiders. Under revised § 547(i), if the debtor makes a transfer to a non-insider for the benefit of an insider during the period between ninety days and one year prior to the
commencement of the bankruptcy case, the trustee can avoid the transfer as a preference only with respect to the insider and not with respect to the non-insider transferee. The revision completes the task of statutorily reversing In re DePrizio, 874 F.2d 1186 (7th Cir. 1989)(debtor’s payment to non-insider creditor outside of the 90-day preference period, but within the one-year insider preference period, that reduced the liability of an insider guarantor could be recovered from the non-insider creditor). See also § 550(c).

- **Extended Periods for Deferred Perfection.** Revised § 547(e)(2)(A) increases the safe harbor period from 10 to 30 days for a secured party to perfect its attached security interest, so that the transfer for preference purposes will occur on the date of attachment. In addition, revised § 547(c)(3) increases the “purchase-money defense” time period, in which a secured party must perfect a purchase-money security interest, from 20 to 30 days after the debtor receives the collateral. However, these revisions apply only to preferences. The secured party must still perfect its purchase-money security interest within the 20-day period required by UCC § 9-317(e) to prevail over an intervening lien creditor, including a bankruptcy trustee under § 544(a), and must timely take the perfection and other steps required by UCC § 9-324 to prevail over an earlier filed secured creditor with a security interest in after-acquired collateral encompassing the purchase-money collateral. Moreover, a non-purchase money secured party will still need timely to comply with the normal Article 9 perfection and priority rules in order to prevail over a lien creditor, including a bankruptcy trustee under § 544(a), and over a competing secured party.

- **Expanded Ordinary Course Defense.** Revised § 547(c)(2) reduces the number of elements needed to establish an “ordinary course of business” defense to the trustee’s action to avoid a payment as a preference. Under former § 547(c)(2), the transferee of the payment was required to establish that the debt was incurred in the ordinary course, the payment was made in the ordinary course, and that the payment was made according to ordinary business terms. Revised § 547(c)(2) provides that the transferee must now only show that the debt was incurred in the ordinary course, and either the payment was in the ordinary course or the payment was made according to ordinary business terms. The revised § 547(c)(2) will broaden the ordinary course of business defense for a secured party receiving payments of principal and interest on its secured loan. The broadened defense will be especially valuable to a secured party that is unable to demonstrate that the payment came from the secured party’s collateral and therefore had no preferential effect under § 547(b)(5).
• **De Minimus Standard.** Section 547(c)(9) has been added to the Bankruptcy Code to provide that the trustee may not avoid a transfer as a preference if the value of the transfer is less than $5,000. The new section will enable a secured party to defend a preference action for a payment during the preference period on its secured loan of less than $5,000 or on the attachment or perfection during the preference period of a security interest in collateral of less than $5,000 in value. It is unclear whether the $5,000 threshold refers to a single transfer or whether multiple transfers during the preference period must be aggregated.

• **Restricted Commercial Venue.** 28 USC § 1409(b) has been amended to provide that a trustee in a case under Title 11 must commence a proceeding to collect a debt of less than $10,000 against a non-insider in the district court for the district in which the defendant resides. A proceeding to collect a debt includes an action by the trustee to avoid a payment to a secured party as a preference. Unless there are numerous alleged preferences from defendants residing in a single district, even the appointment of a local counsel to pursue small preferences may not be warranted.

**Fraudulent Transfer.** Revised § 548 expands the prepetition period in which the trustee may avoid a fraudulent transfer by extending the federal look-back period for avoidable fraudulent transfers from 1 year to 2 years before the commencement of the case. The amendment is effective on April 21, 2006.

**Financial Contracts.** The amendments expand the scope of the “safe harbor” financial contract provisions by which derivative and other financial contract transactions - securities contracts, swaps, forwards, commodity contracts and repurchase agreements - are not subject to the automatic stay, preference provisions or constructive fraudulent transfer provisions of the Bankruptcy Code. The definitions of the various contracts protected by the provisions are broadened, the market players who can benefit from the provisions are expanded, and cross-product netting is permitted. Coordinating amendments were made to the Federal Deposit Insurance Act (FDIA), the Federal Deposit Insurance Corporation Improvement Act of 1991 (FIDICIA) and the Securities Investor Protection Act of 1970 (SIPIC). The provisions affect financial contracts secured by security interests in deposit accounts, investment property and other collateral.

**Cross-Boarder Insolvencies.** The Act creates a new chapter of the Bankruptcy Code, Chapter 15, to deal with issues relating to cross-boarder insolvencies. Of particular importance for secured parties are §§ 1521(a)(5) and 1522(a). Section 1521(a)(5) provides that upon recognition of a foreign proceeding, a US court may permit a turnover of the debtor’s assets within the United States, including a secured party’s collateral, to the foreign representative. However, under § 1522(a), a US court may permit a turnover to the foreign
representative only if the creditors and other interested entities are “sufficiently protected.” The meaning of “sufficiently protected” for a secured party is likely to be given a meaning equivalent to “adequate protection” in the context of § 363(e).

Single Asset Real Estate Debtors. The definition of “single asset real estate” for purposes of stay relief under § 362(d)(3) is amended to eliminate the prior $4,000,000 secured debt cap. The definition basically refers to a debtor that owns a single real estate project generating substantially all of the debtor’s gross income and as to which the business conducted is substantially limited to a real estate operation. Single asset real estate would include a commercial rental property but only a residential rental property with four or more residential units. The changes to § 362(d)(3) will require more qualifying debtors, in order to avoid the lifting of the automatic stay, to file a reorganization plan more quickly or to pay any real estate secured lender, as adequate protection, ongoing monthly interest on its loan at the applicable non-default contract rate. A real estate secured lender may include a personal property secured party with a security interest in fixtures.

II. PROVISIONS OF THE ACT THAT INDIRECTLY IMPACT SECURED TRANSACTIONS

Administrative Expenses and Priorities. Many of the Act’s revisions to the Bankruptcy Code’s administrative expense and priority sections increase the debtor’s cash obligations to confirm a plan in a Chapter 11 case. Increasing these cash obligations may deter a debtor from filing a Chapter 11 case or may result in more § 363 asset sales without a plan or in courts dismissing Chapter 11 cases or converting more Chapter 11 cases into Chapter 7 cases. They may also in some cases, as a practical matter, force secured parties that wish to use Chapter 11 as a means of liquidating their collateral to bear these larger expenses as a “tollgate tax” for using the Chapter 11 process. Among the revisions to the administrative expense and priority sections that increase the debtor’s cash obligations in order to confirm a plan are the following:

- Goods Sold in the Ordinary Course and Non-Reclaimed Goods. Revised § 503(b)(9) grants the seller of goods an administrative expenses claim for the value of any goods sold to the debtor in the ordinary course of the debtor’s business and that the debtor receives within 20 days before the commencement of the case. A seller of goods that fails to give a timely reclamation notice under revised § 546(c) may still assert its rights under revised § 503(b)(9).

- Employee Wage and Benefit Priorities. Revised § 507(a)(4) expands the wage priority for each qualifying individual up to $10,000 (from $4,925) earned within 180 (from 90) days before the petition date. Similarly, § 507(a)(5) enhances priority claims for contributions to employee benefit plans.
• **Tax Claimants.** The Act amends § 1129(a)(9)(C) to provide that tax claims must be paid within 5 years after the date of entry of the order for relief, and the taxing authority must be paid in a manner not less favorable than other non-priority unsecured claims provided for by the plan. The Act also creates a new section of the Bankruptcy Code, § 511, to provide that the rate of interest on a tax claim, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, shall be the rate determined under applicable nonbankruptcy law. The provisions would affect secured, administrative and priority tax claims.

• **Patient Care and Consumer Privacy Ombudsmen.** Under newly created § 333, if the debtor is a health care business, the court is required to appoint an ombudsman to monitor the quality of patient care and to represent the interests of the patients. Under revised § 363(b), in certain circumstances, a court is required to order the appointment of a consumer privacy ombudsman to protect consumers’ privacy in the context of § 363 sales. The expenses of a patient care or consumer privacy ombudsman will be administrative expenses and may put pressure on secured parties to increase their “carve outs” to provide for such expenses.

**Standards for Conversion or Dismissal of a Chapter 11 Case.** Amendments to § 1112(b) increase the probability that a Chapter 11 case will either be dismissed or converted into a Chapter 7 case, whether at the request or over the objection of a secured party. Among those revisions are the following:

• **Increased Grounds for Dismissal.** Revised § 1112(b) expands the grounds for conversion or dismissal of a Chapter 11 case by increasing the non-exhaustive list of “causes” for conversion or dismissal, including, for example, unauthorized use of a secured party’s cash collateral after the order for relief.

• **Restricting the Court’s Discretion.** Revised § 1112(b) requires a court to convert or dismiss a Chapter 11 case if a movant establishes cause, unless certain exemptions provided in the statute are met. Former § 1112(b) granted a court the discretion to either dismiss or convert the case, or do neither.

• **Expedited Process.** Revised § 1112(b) requires a court to hold a hearing within 30 days after the filing of a motion requesting conversion or dismissal, followed by a decision within 15 days after the hearing.

**Debtor’s Bargaining Power in a Chapter 11 Case.** Various amendments throughout the Act reduce the debtor’s bargaining power with its creditors in a Chapter 11 case:
• **Exclusive Period to File Plans.** Revised § 1121(d) limits the period of time during which the debtor can exclusively file a plan and solicit votes. Under revised § 1121(d) the 120 day exclusive period to file a plan may not be extended beyond a date 18 months after the order for relief and the 180 day exclusive period to solicit votes may not be extended beyond a date 20 months after the order for relief. By limiting the length of the debtor’s exclusive periods, the changes may increase the opportunity for a secured party to file its own plan. The changes may also, of course, increase the opportunity for a creditors’ committee or other interested person to file a plan in competition with a plan of the secured party or even the debtor, thus increasing the costs and duration of the Chapter 11 case.

• **Assumption and Rejection of Nonresidential Leases.** Revised § 365(d)(4) expands the amount of time in which a debtor must assume or reject a nonresidential real property lease from 60 to 120 days from the date of the order for relief. However, the provision limits the court’s ability further to extend that period. Under revised § 365(d)(4), a court for cause may extend the period to assume or reject a nonresidential real property lease for only ninety days (from the initial 120 days) and any subsequent extension may be granted only with the prior written consent of the landlord in each instance. These changes may have a significant impact on debtors that might have off-balance sheet value in below-market nonresidential real estate leases, such as multi-store retailers, by causing premature assumptions or rejections of leases. They may also result in more negotiated bargains with landlords for debtors to obtain the landlords’ consents to further extensions of time for the debtor to assume or reject. In addition, the changes may have a significant impact on the debtor’s inventory financing since an inventory lender may require that the duration of its credit facility be shortened in the event that the time to assume or reject a lease of real property on which the inventory is located is not extended.

• **Utilities.** Subject to its receiving adequate assurances of payment within 20 days after the order for relief, a utility may not under § 366 alter, refuse or discontinue service to a debtor solely on the basis of the commencement of a bankruptcy case or the debtor’s prepetition default in payment. Section 366(c) defines “adequate assurances”. The Act’s amendments to that section make clear that, among other things, the mere availability of an administrative expense priority is not sufficient. The changes should result in a debtor’s greater need for cash deposits or letters of credit to secure utility obligations and could affect the debtor’s borrowing needs. The changes in the law may be especially difficult for manufacturing debtors with high utility charges and for retail debtors with many locations.
Transfers by a Nonprofit Charitable Organization. Revised § 363(d) provides that sales of property by a debtor that is a non-profit charitable corporation or trust must be made in accordance with applicable nonbankruptcy law that governs transfers by such entities. This change may reduce the number of § 363 sale potential buyers of the assets of such a debtor in which a secured party has a security interest.
Third Circuit Protects Lender Expectations Regarding Corporate Separateness in Lending to a Group of Affiliated Companies

By Patrick J. Potter, Rick B. Antonoff and Andrew J. Love
Pillsbury Winthrop Shaw Pittman LLP

The Third Circuit’s recent decision in In re Owens Corning offers comfort to lenders who have relied upon the separate existence and credit of affiliated parties in a financing. An important lesson from the court’s decision is that credit underwriting and loan terms should evidence the lenders’ reliance on the separateness of guarantors from the related borrowers.

Many lenders are concerned about the potential impact on a financing transaction of a future bankruptcy of a borrower, including the risk that in the bankruptcy the creditors of some members of an affiliated group of companies may try to reach the assets of more creditworthy members of the group (even without a direct claim on those assets). This is particularly true where the financing is a securitization or other structured financing relying on the bankruptcy remoteness of a borrower, a financing that relies on structural subordination, or a financing relying on the financial strength of one party to provide credit support for the financial risks associated with lending to a related party.

The “tool” that creditors use to attempt to reach the assets of creditworthy parties to the detriment of the lender is the argument that the legal separateness of affiliated entities should be ignored and instead the entities should be “substantively consolidated” – i.e., treated as a single entity with all of their assets available to satisfy all creditor claims (effectively eliminating structural subordination, intercompany guarantees and other lender protections). Whether the bankruptcy court orders a “substantive consolidation” turns on factors such as the extent to which the entities involved followed appropriate corporate formalities, the extent of commingling of those entities’ assets, the expectations of creditors and the relative harm and benefits to creditors.

The recent case of In re Owens Corning, 419 F.3d 195 (3d Cir. 2005), offers comfort to lenders who have relied upon the separate existence and credit of affiliated parties in a financing.

In Owens Corning, a syndicate of lenders had provided a $2 billion unsecured credit facility to Owens Corning and certain of its subsidiaries, and obtained guarantees of certain other Owens Corning subsidiaries. The guarantees gave the lenders direct claims against the guarantors’ assets for repayment of the loan.

Owens Corning and seventeen of its subsidiaries subsequently filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Their proposed plan of reorganization included a provision “deeming” that a consolidation of the debtors
had occurred. A significant impact of this deemed consolidation would have been that all intercompany guarantees (including the guarantees made for the benefit of the lenders) would be eliminated, effectively diluting the claims of the lenders and permitting all creditors to be paid from the combined assets of all entities (rather than the normal case of non-guaranteed obligations being paid only by the entity liable on the obligation). The lower court granted the plan proponents’ request to substantively consolidate the entities over the objection of the lenders and other parties.

On appeal, the Third Circuit held that the deemed substantive consolidation was not appropriate. The court began by agreeing with earlier decisions stating that substantive consolidation should be used sparingly. However, the Third Circuit did not expressly adopt either of the prevailing tests used by courts to determine when substantive consolidation is appropriate, and articulated a standard that may make it even more difficult for creditors seeking to impose that remedy. The court held that the assets and liabilities of entities should be substantively consolidated only if (i) before the bankruptcy case is filed the entities disregarded separateness so significantly that their creditors relied on the “breakdown of entity borders” and treated them as one legal entity or (ii) after the bankruptcy case is filed their assets and liabilities are “so scrambled that separating them is prohibitive and hurts all creditors.” Applying this test, the Third Circuit found that substantive consolidation did not fit the facts of the Owens Corning case, and that the deemed consolidation sought in the plan of reorganization was inconsistent with all the principles that courts should consider when deciding a substantive consolidation request. In the court’s view the lenders “did the ‘deal world’ equivalent of ‘Lending 101’” and, relying on the separateness of the entities, structured their financing to achieve structural seniority (i.e., obtain direct claims against the guarantors and their assets) that other creditors of Owens Corning did not have. The court rejected arguments that the lenders had not in fact been relying on the separateness of the entities because the lenders did not obtain separate financial statements or legal opinions that substantive consolidation was not likely. The court also found that (other than some sloppy bookkeeping) the entities were in fact maintained as separate and distinct legal entities so that the “prohibitive unscrambling” standard had not been met. The court determined that substantive consolidation was particularly inappropriate under the circumstances because the plan proponents were utilizing substantive consolidation as an offensive weapon to achieve leverage in the plan negotiation process rather than its appropriate use of remedying identifiable harms.

In part, the Third Circuit was persuaded that the lenders had in fact been relying on the separateness of the guarantors. The court’s opinion specifically noted that the lenders had required the guarantees from the inception of their discussion of the financing (and would not have made the loans without the “credit enhancement” provided by the guarantees, given Owens Corning’s poor credit rating and growing asbestos liability), and that the loan documents contained covenants intended to protect the legal separateness and the financial
strength of the guarantors (such as limitations on merger of subsidiaries into the parent, mergers among the subsidiaries that would adversely impact the guaranty or transactions with the parent that would result in losses to a subsidiary).

Lenders who have relied upon the separateness of affiliated entities in underwriting and documenting a financing should take comfort in the Third Circuit’s approach to substantive consolidation, particularly where the proponents of substantive consolidation are utilizing the doctrine solely as a sword to disenfranchise lenders (as was the case in Owens Corning). One important lesson for lenders from the Third Circuit’s decision is that documenting at the outset of the transaction the importance of the legal and financial separateness of the affiliated companies will significantly strengthen the lender’s position if other creditors seek substantive consolidation.
MESSAGE FROM THE CHAIR:

COMMERCIAL FINANCIAL SERVICES COMMITTEE

By:
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We are saddened to let you know that on January 8, 2006, Chris Rockers’ wife, Judi passed away following unexpected complications during surgery. All of our thoughts go out to Chris, their six young children and family at this difficult time. The family has suggested that memorial contributions be made to Holt International Children's Services, Waiting Child Fund, P.O. Box 2880, Eugene, Oregon 97402. If you would like to contact Chris to express your sympathy, his address is Christopher Rockers, c/o Husch & Eppenberger, LLC, 1200 Main, Suite 1700, Kansas City, MO 64105.

November 21, 2005

The Committee on Commercial Financial Services is wrapping up a busy year. Since our last newsletter we have met in conjunction with the Annual Meeting of the ABA in Chicago, and have met at the Annual Convention of the Commercial Finance Association earlier this month in San Diego. We have also been very busy planning for our meetings in Tampa at the 2006 Spring Meeting and in Honolulu for the Annual Meeting of the ABA in August 2006.

At the Annual Meeting in Chicago, we presented, along with Banking Law, Business Bankruptcy and UCC, a jointly sponsored program which addressed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The program was titled “The Practical Impact of the Bankruptcy Reform Act of 2005 for Business, Financial and Transactional Lawyers”, and was moderated by Meredith Jackson of Irell & Manella LLP in Los Angeles. We also presented a Committee Forum titled “Second Lien Financing: Negotiating the “Silent Second” which was chaired by Tony Callobre of Sheppard Mullin in Los Angeles. We had a great turnout and Tony has agreed to chair our new “Syndications and Lender Relations Subcommittee – more on that later.

The Committee has just wrapped up our programs presented at the Commercial Finance Association’s annual convention. We had our stand-alone Committee meeting on November 9th and the programs included a presentation chaired by Kimberly Winick of Mayer, Browne Rowe and Maw LLP (Kimberly is currently the vice chair of our Loan Workouts Subcommittee) titled “The Devil’s in the Details: Think While You Draft”. Panel members included Mikel Bistrow of Duane Morris LLP and Jerome Grossman of Luce, Forward, Hamilton & Scripps LLP. Norm Powell of Morris, James, Hitchens & Williams LLP led a program, along with Jennifer Klemm of the First American UCC Division and Harry Sigman, titled “More than Wishing and Hoping and Praying: Searching and Filing Under Article 9”. Leianne Crittenden of Oracle Financing Division (and who is also a co-chair of our Intellectual Property Financing Subcommittee) chaired a program which dealt with the challenges of perfecting a security interest in “different” types of collateral. The program was titled “What’s Under the Blanket: Perfecting in Collateral Not Covered by a UCC Filing” and Leianne discussed issues surrounding software was collateral. Jim Tussing of Fulbright & Jaworski L.L.P. discussed the Cape Town
We have already started planning for our meetings in 2006. The Spring Meeting will be held in Tampa, April 6-9. In addition to the annual Commercial Law Developments by Steve Weise and Teresa Harmon, we will jointly sponsor, with UCC, a report of the Joint Task Force on Deposit Account Control Agreements. We also will be presenting a program titled “The Price of their Toys: Financing Boats, Planes and Sports Teams.” For the last two years, CFS has sponsored a program which is presented to the New Lawyer Institute held in connection with the Spring Meeting. That program, titled “Understanding and Documenting Commercial Loans: A Beginner’s Guide” will be presented again in Tampa and will be chaired by Susan Tyler of McGlinchey Stafford, PLLC.

The Annual Meeting will be held in Honolulu, August 4-8 and we have already started to plan. The Committee will present a program titled “Is the World Really an Oyster: Current Issues in Trade Finance”.

Commercial Financial Services has formed a new subcommittee. We have continued to sponsor programs which deal with multi-lender issues and it seemed appropriate that we establish a subcommittee to address those topics on an ongoing basis. In October I sent an email to the Committee which began the rollout, and the response was tremendous. I received over 100 replies from interested members. The Syndications and Lender Relations Subcommittee will be chaired by Tony Callobre at Sheppard Mullin, Richter & Hampton, LLP and is scheduled to meet at the Spring Meeting and at the Annual Meeting.

The Committee has identified a number of opportunities to present substantive material, including programs, committee forums, subcommittee meetings and publications. If you are interested in presenting or becoming active in Committee work, or if you would like to see a specific topic addressed, please give me a call. Happy Holidays and I look forward to seeing you in Tampa.
Commercial Law Newsletter – December 2005

MESSAGE FROM THE CHAIR

UNIFORM COMMERCIAL CODE COMMITTEE

By: Stephanie Heller
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November 22, 2005

I am excited to report that at the 2005 Annual Meeting the UCC Committee presented the first ever UCC Award for Exceptional Service to Fred Miller. This award recognizes exceptional work and sustained service of individuals in the development and advancement of the UCC and commercial law. I am confident that all would agree with the decision of the UCC Committee leadership that Fred Miller’s forty years of service to commercial law and the UCC exemplifies this standard.

The event itself, which took place during the full UCC Committee meeting, was rather informal. This was not without some thought. As I said during the presentation, I think of the UCC Committee as a family and we wanted to make sure that this special event was open to all of our family. After some brief remarks from me, which will be published in the next issue of the Consumer Finance Law Quarterly Report, Fred was gracious enough to share some of his thoughts about the past and future of commercial law. I know I speak for all who were there when I say thank you Fred.

In sharp contrast to the quiet dignity of the award ceremony, the joint UCC and CFS Committee dinner could only be described as a musical event of questionable character. And while I vaguely recall taking some oath that what happened at Ditka’s would stay at Ditka’s, I simply cannot resist. Imagine after a long day of ABA meetings and more networking than you may have counted on, you finally settle down for the good food and fine wine for which the UCC/CFS dinner has come to be known, when all of a sudden Norm Powell takes his position at the key board. Oh did I forget to mention there were microphones and a piano? The vamp begins and then, without much warning and a cast of thousands (ok maybe 10 or 11) rush the stage and shamefully perform for the crowd. The intrepid cast included the following:

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<tr>
<th>Tony Callobre</th>
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<td>Stephanie Heller</td>
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<td>Lynn Soukup</td>
<td>Kathi Allen</td>
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<td>and Norm Powell</td>
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Those who were there no doubt have their own words to describe the spectacle – for me the word was fun! For those who missed it, let me tempt you with a few of the lyrics (the full text of all of the songs is attached).

In recognition of Ed Smith, Marshall Grodner and the many others who have spent hours working on the model Deposit Account Control Agreement, the group began with DACA sang to the tune of Heartbreak Hotel.

I'm the depositary
You better treat me right
Indemnified, expenses paid
Protected in a fight

Three party agreement, lender
To get control
To get control priority

As one of the lucky few to be asked to sing with the group (and consequently was not forced to listen to the group), I can report that the group favorite was Silent Second, sung to the tune of Desperado by Linda Ronstadt/The Eagles.

Silent second
You've got to stay in your corner
I'm not gonna warn ya
It's what we agreed
You're to be quiet
And let me handle the debtor
Decide on what compromise
And what remedy

And what could be more fitting for the UCC Committee then a finale of Let's Do Revisions Again (To the tune of Time Warp from The Rocky Horror Picture Show)

{Riff Raff}
Do you remember
Drafting sessions
Plugging every hole
Writing the comments

{Magenta}
To teach the judges

{Riff Raff}
The meaning of control

I remember revising the statute
Fixing every bad case
Now that it's finished I have the feeling
{Riff Raff and Magenta}
We'd best pick up the pace

{Transylvanians}
Let's do revisions again
Let's do revisions again

{Narrator}
First NCCUSL's on board

{All}
ALI signs up too

{Narrator}
ABA gives a course

{All}
And you think we are through
It's knowing the answers that really drives you insane
Let's do revisions again
Let's do revisions again

The lyrics were brilliant thanks primarily to Lynn Soukup. And Norm's accompaniment was nothing but heroic!

Let me end this column on a more serious note with a preview of the programs that the UCC Committee will present at the Spring Meeting in Tampa in April. On Thursday, April 6th we will present a CLE Program entitled "Avoiding the Pitfalls of UCC Practice." For this program to be a success, we need your help. Committee members are asked to send any tips they have developed or come across to aid them in their UCC practice to Stephen Sepinuck (ssepinuck@lawschool.gonzaga.edu) today. These might include something to put into an agreement, something to lookout for in negotiating a deal or litigating a dispute, or some way to protect a client's rights or expectations. The ideas will be organized by subject and those who submit them (and who attend the meeting) will be asked to explain them in 2 minutes or less, with then a brief amount of time for questions.

On Friday, April 7th we will have our full UCC Committee Meeting where we will once again play Stump the Chumps. This new UCC Committee tradition is one that you will not want to miss. Immediately following the UCC Committee meeting, we will hold our Committee Forum. This forum, which is jointly sponsored with the CFS Committee, is entitled "Using the New Model Deposit Account Control Agreement." Then on Saturday we will sponsor one final CLE program entitled "UCC v. International Law: Clash of the Titans."

Finally, I would like to mention a special meeting that the UCC Committee will host jointly with other committees including the CFS Committee on Bank Deposits. This meeting will be used to debate and discuss whether it makes sense for an organization such as NCCUSL to undertake a project to create a Model or Uniform Law of Bank..
Deposits. Such legislation could deal with setoff rights, issues related to jointly held accounts, and numerous other matters.

In closing I want to thank all of you who support the many programs and activities of the UCC Committee. As I have said many times before, I am very proud to be associated with such an incredible group of people and excited about the work that our subcommittees, working groups and task forces are doing.

Stephanie Heller
Chair
Uniform Commercial Code Committee
CFS Aircraft Financing Subcommittee of Commercial Financial Services Committee

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New York, NY
jtussing@fulbright.com

Michael K. Vernier, Vice-Chair
Standard & Poors Ratings Services
New York, NY
Michael_Vernier@standardandpoors.com

The Aircraft Finance Subcommittee would like to report that a significant change in U.S. and international aircraft finance law is about to occur with the long awaited implementation of the Cape Town Convention. The Convention was originally approved in a diplomatic convention attended by representatives of sixty-eight countries in Cape Town, South Africa in 2001. It was ratified by the United States in 2004. With its ratification by an eighth country, Malaysia, on November 2, 2005, it will become effective on March 1, 2006.

Under Cape Town, it will be necessary to make an electronic filing at an international aircraft registry in Ireland in order to perfect an “international interest” in (1) aircraft that transport at least eight people (including crew), (2) aircraft engines of at least 550 horse power and (3) helicopters that transport at least five people (including crew). An “international interest” includes a security interest, a conditional sale, a lease and, in some cases, a contract of sale. Cape Town also prescribe a number of remedies designed to facility repossession and de-registration of aircraft equipment following a default. Cape Town will not apply retroactively to existing filings and transactions although creditors may wish to make Cape Town filings for such transactions in some cases in order to gain the benefits of the Convention.

In the United States, Cape Town will be implemented on March 1, 2006 under the terms of: (a) the Cape Town Treaty Implementation Act of 2004, which selected the Federal Aviation Administration (FAA) Aircraft Registry in Oklahoma City as the “portal” through which filings with the International Registry will be made and (b) amendments published at 70 FR 240 et seq, January 3, 2005 to the FAA’s regulations governing Aircraft Registration and Recording of Aircraft Titles and Security Documents at 14 CFR Parts 47 and 49. Under these procedures, for closings involving U.S. registered aircraft and aircraft engines it will continue to be necessary to file full security and lease documents with the FAA Registry. Following such filings parties will obtain a special authorization code from the FAA that will enable them to make a simple electronic notice filing with the International Registry. It will be necessary to conduct prior searches of both the International Registry and the FAA Registry to identify existing liens.

Cape Town has been promoted by manufacturers and financiers of aircraft and aircraft engines as a means of encouraging the global financing and leasing of aircraft by enhancing the legal protections available to creditors that finance aircraft. The U.S Export-Import Bank has announced that it will substantially reduce its fees on asset
backed financings of U.S. manufactured aircraft and aircraft engines to which Cape Town applies. It is expected that many more countries will ratify Cape Town.
Thank you to everyone who attended the August 8, 2005, joint meeting of the UCC Subcommittee on Payments and the Banking Law Subcommittee on Payments and Electronic Banking at the ABA’s annual spring meeting in Chicago. The session focused on recent developments in electronic banking products. In a presentation entitled *Clash of the Titans Redux: Competing Electronic Payment Products Five Years After the Collapse of the Dot Com Bubble*, panelists described how the Olympians—new technologies and business models that five years ago appeared to be the wave of the future—have largely succumbed to the old Titans—regulated financial intermediaries.

In the course of the presentation, the panel noted how ACH use has increased as NACHA has introduced a number of new applications in recent years, including re-presented check entry (RCK), point-of-purchase entry (POP), Internet-initiated entry (WEB), telephone-initiated entry (TEL), and accounts receivable entry (ARC). The panel also observed how prepaid (or stored-value) cards have largely displaced so-called smart cards and discussed how prepaid cards present challenges to regulators as well as banks. Last, the panel reviewed the complaint filed in *Ahlo, Inc. v. Bank of America Corp.* (Fla. Cir. Ct., No. 05-2538-CA27, filed Feb. 3, 2005), which involves an allegedly unauthorized funds transfer to a bank in Latvia from the account of a Florida-based computer and copier supply services company. Among other things, Ahlo alleges that Bank of America induced it to switch to online banking without warning it of possible risks. In addition, Ahlo alleges that Bank of America’s online banking security procedures were inadequate. The case served to highlight the broader question raised at the meeting about whether existing law provides adequate incentives to manage the computer security risks inherent in electronic payments.

At the joint meeting, the UCC Subcommittee on Payments also distributed a revised *draft matrix of retail electronic payment products* which updates a version prepared more than four years ago. The subcommittee is seeking broad comment on the matrix, including whether practitioners find it useful. Anyone interested in volunteering to assist on this project is asked to contact Marina Adams or Greg Cavanagh; their contact information is included in the cover page to the matrix.

At the upcoming spring Business Law section meeting in Tampa, the UCC Subcommittee on Payments, working in conjunction with the leadership of the full UCC Committee as well as other Business Law committees such as CFS, will host a special two-hour meeting to discuss the pros and cons of drafting a new law on bank deposits. The program is slated to take place on Friday, April 7, 2006, from 8 to 10 a.m. Please be sure to check the final meeting schedule for any changes.
Last, the UCC Subcommittee on Payments intends to sponsor a forum on the new Iraqi payments system at the 2006 annual meeting in Hawaii.

We look forward to seeing all of you in Tampa.
Commercial Financial Services & UCC Committees
Pro Bono Committee Liaison Report

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khopkins@rp-lawgroup.com

As the co-chair of the Section's Pro Bono Committee and your liaison, I am pleased to report some wonderful developments in the Section’s pro bono and public service activities. As you may know, our Section has a strong, substantial commitment to providing pro bono to our communities and cultivating opportunities for its members within their practice areas. We are also hiring new staff counsel engaged by the Section and housed in the ABA Center for Pro Bono to work exclusively on Business Pro Bono Projects.

The Pro Bono Committee is presently updating its website http://www.abaprobono.org/businesslaw. Please visit the site for information on one of the Section’s showcase projects: A Business Commitment (ABC). ABC is a project adopted by local and state bar associations, ad hoc groups and law schools around the country to provide community based non-profit organizations and micro-entrepreneurs with pro bono business legal advice. We currently have over 30 active projects around the country (and growing); and on March 30-April 1 2006 at the ABA’s Equal Justice Conference in Philadelphia we will be providing a full day of programming for bar leaders and existing ABC project coordinators on how these projects can be set up, grow and succeed.

In addition, we have been working with four BLS task forces on addressing the needs of hurricane victims. These task forces include Bankruptcy, Community Development, Debt Deferment and Small Business Assistance. Our task forces are looking for volunteers interested in providing memoranda and white papers to be used by local pro bono counsel. The website also allows members to register as volunteer attorneys and to register available office space and other assistance. If you are interested in providing your expertise, please click on: http://www.abanet.org/buslaw/katrina/

Finally, as a reminder the Section has its own 503(c) charitable fund to support our pro bono, diversity and public service initiatives. It is a sub-fund of the ABA FJE, and you can make contributions through either the BLS or directly through the FJC. Thank you in advance for your commitment to all these important projects!
## UNIFORM STATE LAWS SCORECARD

Survey of Adoptions of Revised Official Text of the UCC

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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 the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) for their help in compiling the information above. These revisions are based on information provided by NCCUSL available as of November 8, 2005.

1. In addition to enactments noted below, all states and the District of Columbia have adopted (i) the 1995 Official Text of Article 5 of the UCC, other than Wisconsin, (ii) the 1994 Official Text of Article 8 of the UCC and (iii) the 1998 Official Text of Article 9 of the UCC.

2. New York and South Carolina are the only states that still have the 1951 version of Articles 3 and 4.
Chair:
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Tel:  816.283.4608
Fax:  816.421.0596
Email: christopher.rockers@husch.com

Term expires: Following Annual Meeting – August, 2007

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Email: lynn.soukup@pillsburylaw.com

Term expires: Following Annual Meeting – August, 2007

Subcommittees, Liaisons and Other Leadership Positions

See pages that follow
Agricultural and Agri-Business Financing

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Term expires:  Following Annual Meeting – August, 2008

Vice Chair:
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Term expires:  Following Annual Meeting – August, 2008
Aircraft Financing

Chair:
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Term expires: Following Annual Meeting – August, 2006

Vice Chair:

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Term expires: Following Annual Meeting – August, 2006
Creditors’ Rights

Chair:
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Fax: 404.962.6667
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Term Expires: Following Annual Meeting – August, 2008

Vice Chair:
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Email: rln@severson.com

Term Expires: Following Annual Meeting – August, 2008
Cross-Border Secured Transactions

Chair:
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