Commercial Law Newsletter

Messages from the Chairs

Committee on Commercial Financial Services
Christopher J. Rockers, Chair

The Committee on Commercial Financial Services is meeting at the Annual Meeting of the American Bar Association in Honolulu, Hawaii on August 4 through 6, 2006. Each year at the Annual Meeting we typically meet over the course of a weekend and this year in Hawaii it will be no different. Our subcommittee meetings and programs will be held in the morning and will allow our members to enjoy their time in Hawaii. CFS, as with many of the other Committees, will offer a more limited schedule, however many of our larger subcommittees will meet and will provide substantive presentations.

Jim Chadwick, Patton Boggs LLP in Dallas, will chair a trade finance program Friday morning August 4, 2006, from 11:00 am to 1:00 pm. This program will be titled “Is the World Really an Oyster: Current Issues in Trade Finance” and his panel will include B. Otis Felder, St. Clarita, California of Princess Cruises and Brian R. St. James of the CIT Group in New York. Jim’s program promises to be a great primer on financing imports and exports and will include a detailed analysis of complications, problems and solutions in the area of trade finance.

Committee on Uniform Commercial Code
Stephanie Heller, Chair

Once again I have to thank the UCC Committee leadership for putting together another fabulous set of meetings and programs at the 2006 Spring Meeting in Tampa. I also wish to express my gratitude to all the individuals who participated in our formal CLE Programs as well as our subcommittee mini programs. I am sure I say this after each meeting, but I truly believe that Spring 2006 was one of our best. In fact, one of the CLE Programs we presented at Spring Meeting, “Avoiding the Pitfalls of UCC Practice: Commercial Law Practice Tips - A Compendium of Advice for Lawyers from Lawyers,” was featured in the June 2006 edition of eSource. Click here for a slightly updated version of the materials is attached. We are also exploring opportunities to use these materials in future CLE programs delivered in partnership with state and local bar associations as part of an effort to provide regional programming to UCC Committee members. The choice to provide this type of programming regionally is a direct outgrowth of the UCC Committee survey conducted just prior to the Spring Meeting. I wish to thank each of you who responded to the survey. Click here for the results.

Featured Articles
Delaware Update – 2006 Legislation Amending Certain Alternative Entity Laws
Norman M. Powell, Esq

In its legislative session ended June 30, 2006, the Delaware General Assembly enacted amendments to the Delaware Limited Liability Company Act, 6 Del. C. § 18-101 et seq. (the "DLLC Act"), the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. § 17-101 et seq. (the "DLP Act"), and the Delaware Statutory Trust Act, 12 Del. C. § 3801 et seq. (the "DST Act"). These amendments generally take effect on August 1, 2006, with the exception of those related to registered agents under the DLLC Act and DLP Act, which take effect on January 1, 2007.

More...

Spaying and Planned Furniture Or: What Comes Around Goes Around for the IRS
James D. Prendergast

Two recent decisions inject uncertainty into the orderly logic and process of UCC searches, leaving creditors in a conundrum over how to best protect the priority of their security interests.

1. Spaying Tool and Manufacturing Co., Inc.: IRS Law Trumps the UCC

Many of us were shocked by the recent law enunciated by the Sixth Circuit in its decision issued on June 21, 2005, In re: Spaying Tool and Manufacturing Co., Inc., 412 F.3d 653 (6th Cir. 2005). In this case, the bankruptcy court had held that the IRS does not have to follow the equivalent of the Uniform Commercial Code (UCC) debtor-name rules when filing a tax lien and that Crestmark Bank and Crestmark Financial Corporation (collectively, Crestmark), although unable to find an IRS lien filed under a name that could not be found in a UCC search using the ‘correct’ debtor name, was nevertheless junior to the IRS. The district court reversed and held for Crestmark. The Sixth Circuit reversed the district court and affirmed the bankruptcy court’s grant of summary judgment for the government.

More...

Federal Capital Tax Elimination – Implication for Cross-Border Securitization
Martin Fingerhut

Canada has repealed the federal capital tax. The elimination of this tax will facilitate the cross border securitization of various classes of Canadian leases and interest-bearing receivables on a tax efficient basis. This results from the interplay between Canadian withholding tax on the one hand, and provincial capital taxes on the other.

Canada’s withholding tax regime creates a significant hurdle to securitizing leases or interest-bearing receivables in foreign capital markets. Subject to several exceptions, a 25% withholding tax applies to interest or rent paid to non residents. Although this rate is often reduced by treaty, it rarely falls below 10%, and generally renders an off-shore securitization uneconomic.

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

The subcommittee on Agricultural Finance presented its program titled "Rights in the Agricultural Collateral—Fundamental Concepts and Recent Contradictions" at the Spring Meeting of the Business Section. The program analyzed recent cases construing the UCC Article 9 requirement that in order for a security interest to attach, the grantor must have “rights in the collateral.” The focus of the program was on agricultural collateral (especially crops and livestock). Speakers were the subcommittee chair and vice chair, Randy Wright (Baird Holm LLP, Omaha, NE) and Larry Harris, (Melchert Hubert Sjodin, PLLP, Waconia, MN). You can access the materials by clicking on this link.

Although the subcommittee will not gather at the ABA annual meeting, in October, it will convene in Savannah, GA, at the American Agricultural Law Association’s annual meeting. The subcommittee’s topics will include a humorous look at common mistakes in agricultural lending.

CFS Subcommittee on Cross-Border Secured Transactions
James C. Chadwick, Chair, Joseph Turitz, Vice-Chair

At the Spring Meeting in Tampa, our Subcommittee held a joint subcommittee meeting with the UCC Subcommittee on International Commercial Law. The meeting included a presentation, "Sovereign Bond Defaults and Aggressive Creditor Tactics", by Mark Cymrot of Baker & Hostetler and Michael Nelson of the Federal Reserve Bank of New York. Mr. Cymrot and Mr. Nelson discussed recent attempts to seize sovereign assets located inside and outside of the United States, particularly those involving defaulted Argentina sovereign debt. The presentation included a discussion of a Belgian law that was enacted recently in an effort to prevent holdout creditors from attaching Euroclear as a conduit for payments on restructured sovereign bonds. The presentation also included an analysis of the International Centre for Settlement of Investment Disputes as an alternate forum for sovereign creditors. The joint subcommittee meeting was well attended and everyone seemed pleased with the coverage of this timely topic.

More...

CFS Subcommittee on Intellectual Property Financing
Leianne Crittenden, Co-Chair, Thomas M. Ward, Co-Chair, Matthew W. Kavanaugh, Vice-Chair

The CFS Committee’s IP Financing Subcommittee’s meeting at the Spring Meeting in Tampa covered security interests and financing issues that arise when trademarks are financed. Tom Ward discussed how trademark rights (covering goodwill as evidenced by brand or product identity) have different attributes than either software (covering embodiment of ideas) or patents (covering processes), and potential pitfalls that could arise from inadvertent transfers that may result from a financing transaction (such as potential invalidation of trademarks).

The Subcommittee will not be meeting at the ABA Annual Meeting in Hawaii, and the next meeting will be at the ABA Business...

CFS Subcommittee on Loan Documentation
Jeremy S. Friedberg, Chair, Stuart D. Ames, Vice-Chair

"Ethics in Loan Documentation — What's right? What's wrong? What matters?" will be our topic at the August meeting of the Loan Documentation Subcommittee in Hawaii. During this program, Jeremy Friedberg will discuss and analyze, with your help, common ethical issues that face finance lawyers. We look forward to a lively and timely discussion on **Saturday, August 5, 2006. 8:30-10:00 a.m.** at the Marriott's Ballroom 3 on the 3rd Floor.

CFS Subcommittee on Real Estate Financing
Neal Kling, Chair, Kathleen J. Hopkins, Vice-Chair

At the 2006 Spring Meeting, the Subcommittee hosted an outstanding program entitled "Defeasances in Real Estate Financing - the Good, the Bad and the Ugly." The program featured nationally-recognized experts on the topic, Timothy Boyce of Dechert, LLC; Mikel Bistrow of Duane Morris LLP; Josh Cohen of Commercial Defeasances, and Arthur Field of Field Consulting LLC and former chair of the BLS Legal Opinions Committee, discussing how defeasances work, their interplay with defaulting loans and special issues to consider in defeasance opinion letters. Audience participation was terrific.

The materials from this program are hyperlinked to this article, just click here. Please contact the Subcommittee Chair, Neal J. Kling (nkling@shergarner.com) or Vice-Chair, Kathleen J. Hopkins (khopkins@rp-lawgroup.com), if you would like to join the Subcommittee or request any additional information related to the Subcommittee or its activities.

CFS Subcommittee on Securitization and Derivatives
Martin Fingerhut, Chair, Teresa Wilton Harmon, Vice-Chair

Current projects of the Securitization and Derivatives Subcommittee of the Commercial Financial Services Committee include contributing to the drafting of securitization riders for the Model Deposit Account Control Agreement, updating our website and working with the Section of Business Law's Pro Bono Committee to increase awareness of opportunities in microfinance.

Our subcommittee had an excellent meeting in Tampa in conjunction with the ABA Spring Meeting. Following our regular business meeting, Ed Smith of Bingham McCutchen and our Vice-Chair (soon to be our Chair), Teresa Harmon of Sidley Austin, updated us on recent changes to the model Deposit Account Control Agreement, and discussed plans to revise the Agreement to accommodate securitization transactions. Tony Nolan of Goodwin Procter then led a discussion on recent developments in legal opinion requirements under FAS 140 and on true sale opinion issues in various scenarios.
CFS Subcommittee on Syndications and Lender Relations

Anthony R. Callobre, Chair, Michelle White Suárez, Vice-Chair

The Syndications and Lender Relations Subcommittee is currently focusing on two principal projects: (i) exploring developments in intercreditor agreements between first-lien and second-lien lenders (and bankruptcy courts’ interpretations thereof) and proposing a "model" form of intercreditor agreement which will reflect emerging market standards in negotiations between such lenders, and (ii) working with Howard Ruda on a new chapter to be contributed to his treatise, Asset Based Financings: A Transactional Guide, which will focus on the issues and law affecting multi-lender and multi-tranche finance transactions.

Committee on Uniform Commercial Code: Subcommittee Reports

UCC Subcommittee on Leasing

Barry A. Graynor, Chair, Teresa Davidson, Vice-Chair

The Uniform Commercial Code Subcommittee on Leasing met at the Section’s Spring Meeting in Tampa on April 6, 2006. The focus of the meeting was on the legal issues arising in small ticket commercial leasing as well as the intersection between commercial and consumer law. The session was well-attended and Malcolm Lindquist of Lane Powell spoke on “Commercial Small Ticket Leasing – Are You Really Leasing to Consumers”. Both plaintiffs’ and defense firms involved in the Norvergence cases had representatives in the meeting which led to a well-rounded debate.

Attendees agreed that the Subcommittee should increase its activity and one of the upcoming projects is initiating a list-serve distribution for lease issues. Please contact either of the Subcommittee Officers below if you are interested in becoming involved in the Subcommittee activities.

Barry Graynor
graynorba@cooley.com
Phone: 415-693-2136
Fax: 415-693-2222

Teresa Davidson
teresa.davidson@vfso.com
Phone and Fax: 336-931-3806

Joint Task Force, Working Group and Liaison Reports

CFS Subcommittee on Secured Lending / UCC Subcommittee on Secured Transactions Joint Report

Leianne S. Crittenden, Chair (UCC), Pauline Stevens, Vice-Chair (UCC), Malcolm C. Lindquist, Chair (CFS), Katherine Simpson Allen, Vice-Chair (CFS)

The CFS Committee's Secured Lending Subcommittee and the UCC Committee's Secured Transactions Subcommittee held a
joint meeting at the Spring Meeting in Tampa. Neil Cohen (Jeffrey D. Forchelli Professor of Law at Brooklyn Law School) explained why we still need to worry (at least a little) about Former Article 9 in his presentation on *The PEB's RA9 Commentary - The Article That Wouldn't Die*. Steve Leitess (of Leitess Leitess Freidberg + Fedder PC in Baltimore) explained why we need to start thinking (at least a little) about motor vehicle liens, discussing *What You Need To Know About the Uniform Certificate of Title Act Before You Can Go from 0 to 60*. Kathi Allen (of Stites & Harbison PLLC in Nashville) took us on a brief romp through the field of equine financing, with *A Horse is a Horse... Unless it's Collateral*.

The Subcommittees will not be meeting at the ABA Annual Meeting in Hawaii, and the next joint meeting will be at the ABA Business Law Section Spring Meeting in Washington, D.C., March 15-18, 2007. If you have any requests, suggestions or submissions for the Spring Meeting, please contact Pauline Stevens or Kathi Allen.

**CFS and UCC 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 Committees) were published in the July theme issue on the “Business of Fun.” I encourage all members to review their files: are there CLE materials which your associates could help morph into a short, interesting article for the magazine? The criteria for articles requires limited prior publication, but ABA CLEs and newsletters, plus 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).

*Also, consider submitting “hot topics” columns.* Starting this year, the magazine has a rotating column on hot topics in various substantive business law fields. Commercial Finance is certainly replete with changes and nuances which should be shared. The hot topics is a short (600 word maximum) column format with an expedited turn around and may be the perfect vehicle for getting out your message. Other than the shorter format, the same guidelines apply as with full length articles.

**Joint Task Force On Deposit Account Control Agreements**

*Marshall Grodner, Co-Chair (CFS), Ed Smith, Co-Chair (UCC)*

The Joint Task Force on Deposit Account Control Agreements was established by the Business Law Section to develop a form of UCC Article 9 deposit account control agreement 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 completed and presented to the Section at the 2006 Spring Meeting in Tampa a form of deposit account control agreement for a demand deposit account over which the debtor initially has access. The form consists of a short Deposit Account Control Agreement (the “DACA”) to which general terms (the “General Terms”) are incorporated by reference. In addition, the task force prepared an initial report describing the DACA and the General Terms. The initial report, together with the DACA and the General Terms, was published in the February 2006 issue of The Business Lawyer.

The Task Force is now turning its efforts to inserts to the DACA to address standing cash sweeps, lock box arrangements, time deposits and first and second liens on a deposit account. It is also working with the Securitization and Derivatives Subcommittee of the Commercial Financial Services Committee to develop an insert that can be used for the DACA and the General Terms in securitization transactions.

The DACA, the General Terms, the initial report and the current drafts of the various inserts being discussed are all available on the Task Force’s web site for which the URL is http://www.abanet.org/dch/committee.cfm?com=CL710060. Anyone interested in joining the Task Force should feel free to contact Marshall Grodner at mgrodner@mcglinchey.com or Ed Smith at Edwin.Smith@Bingham.com.

UCC Subcommittee on Payments and Banking Law Subcommittee on Payments and Electronic Banking and Subcommittee International Banking

Paul S. Turner, Co-Chair; Steve Veltri, Co-Chair; Marina Adams, Co-Chair

Many thanks to all who attended the April 7, 2006, joint meeting of the UCC, Banking Law, Commercial Financial Services, and Consumer Financial Services Committees at the Spring Business Law Section meeting in Tampa. That meeting considered the question of whether there should be a model or uniform law of bank deposits. Although Articles 3 and 4 of the UCC cover many aspects of deposit, collection, and payment, they are not comprehensive, and much other law—federal, state, and “private”—supplements or overlays Articles 3 and 4. The meeting’s five panelists debated whether model or uniform legislation is needed to fill gaps or to reverse the effect of certain court decisions. In particular, lively discussion ensued over whether such a law should address setoff and various adverse claims.

Looking ahead, the UCC Subcommittee on Payments, in cooperation with the Banking Law Subcommittee on Payments and Electronic Banking and the Banking Law Subcommittee on International Banking, is sponsoring a special 1 ½-hour program on the topic of Iraq. After Baghdad fell to coalition forces in Spring 2003, the banking and financial systems in Iraq were in disarray. In a program entitled Banking on the Tigris, Raleigh M. Tozer, Deputy General Counsel and Senior Vice President at the Federal Reserve Bank of New York, will describe his experiences as one of the American advisers, first to the Coalition Provisional Authority and now to the Iraqi government, involved in the effort to draft and implement laws and regulations giving the Central Bank of Iraq the powers of an independent central bank. He will also discuss the ongoing effort to implement a modern electronic payment system in Iraq. The program is slated to take place on
Saturday, August 5, 2006, between 10:30 a.m. and noon. Please be sure to consult the final meeting schedule for any changes.

We look forward to seeing all of you in Honolulu!

**UCC Subcommittee on Secured Transactions and Subcommittee on Secured Lending**

Malcolm C. Lindquist, Chair (CFS), Katherine Simpson Allen, Vice-Chair (CFS), Leianne S. Crittenden, Chair (UCC), Pauline Stevens, Vice-Chair (UCC)

The CFS Committee's Secured Lending Subcommittee and the UCC Committee's Secured Transactions Subcommittee held a joint meeting at the Spring Meeting in Tampa. Neil Cohen (Jeffrey D. Forchelli Professor of Law at Brooklyn Law School) explained why we still need to worry (at least a little) about Former Article 9 in his presentation on *The PEB's RA9 Commentary - The Article That Wouldn't Die*. Steve Leitess (of Leitess Leitess Freidberg + Fedder PC in Baltimore) explained why we need to start thinking (at least a little) about motor vehicle liens, discussing *What You Need To Know About the Uniform Certificate of Title Act Before You Can Go from 0 to 60*. Kathi Allen (of Stites & Harbison PLLC in Nashville) took us on a brief romp through the field of equine financing, with *A Horse is a Horse . . . Unless it's Collateral*.

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**UCC Scorecard**

**UNIFORM STATE LAWS SCORECARD**

Survey of Adoptions of Revised Official Text of the UCC

As of June 2, 2006

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**Upcoming Events**

**Annual Meeting Schedule of Programs and Committee Meetings**

2006 Annual Meeting Schedules for CFS and UCC Committees can be found by selecting the alphabetical schedule at http://www.abanet.org/buslaw/2006annual/ and going to page 4 for CFS and page 18 for UCC.
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MESSAGE FROM THE CHAIR:
COMMERCIAL FINANCIAL SERVICES COMMITTEE

By:
Christopher J. Rockers
Husch & Eppenberger, LLC
Kansas City, Missouri
christopher.rockers@husch.com

July 6, 2006

The Committee on Commercial Financial Services is meeting at the Annual Meeting of the American Bar Association in Honolulu, Hawaii on August 4 through 6, 2006. Each year at the Annual Meeting we typically meet over the course of a weekend and this year in Hawaii it will be no different. Our subcommittee meetings and programs will be held in the morning and will allow our members to enjoy their time in Hawaii. CFS, as with many of the other Committees, will offer a more limited schedule, however many of our larger subcommittees will meet and will provide substantive presentations.

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As we do every year, Commercial Financial Services will hold its stand-alone Committee meeting in conjunction with the Annual Convention of the Commercial Finance Association. This year, the CFA meets in Washington, D.C. from October 25 thru October 27, 2006, and we will have our traditional meeting on Wednesday, October 25 from 11:00 am – 4:00 pm. Ed Smith and Marshall Grodner will provide an updated report on the work of the Deposit Account Control Agreement Task Force and the implementation of the form presented at the Spring Meeting in Tampa. Ed and Marshall are also preparing a presentation to the Commercial Finance Association on Thursday, October 26. This a great opportunity to profile the work of our Committee and other Committees in connection with the DACA and the work of the Task Force, and to provide direct exposure to those in the industry who will be involved in transactions in which deposit account control agreements play a crucial role.

Other programs which we will present at our stand-alone meeting in Washington will include a program on lending to hedge funds and a program which will address evolving issues in multi borrower transactions. If you are not planning on attending the annual meeting in Hawaii, I look forward to seeing you in October in Washington, D.C.

Each year, immediately following the Annual Meeting, we appoint new leaders to open positions within the Committee. This year is no exception and a number of our
subcommittees will have vacancies. If you attended the Spring Meeting, you probably received a copy of our Committee’s booklet listing names, contact information and terms of each of our leaders. If you did not attend the Spring Meeting or did not receive our leadership list, and would like a copy, please let me know and I will forward a copy to you. If you are interested in discussing a leadership position in our Committee, or otherwise becoming active in Committee work, or if there is a topic you would like to present at a meeting (or have presented), please give me a call.

As a reminder, program materials from the Spring Meeting are available on our web-site and I encourage you to take advantage of that resource.

I look forward to seeing you in Hawaii. We will not have our traditional joint dinner with the UCC Committee, but if you are interested in joining an informal group for dinner, let me know and we will work on putting something together.

Aloha!
Once again I have to thank the UCC Committee leadership team for putting together another fabulous set of meetings and programs at the 2006 Spring Meeting in Tampa. I also wish to express my gratitude to all of the individuals who participated in our formal CLE Programs as well as our subcommittee mini programs. I am sure I say this after each meeting, but I truly believe that Spring 2006 was one of our best. In fact, one of the CLE Programs that we presented at Spring Meeting, “Avoiding the Pitfalls of UCC Practice: Commercial Law Practice Tips - A Compendium of Advice for Lawyers from Lawyers,” was featured in the June 2006 edition of ABA Section of Business Law eSource. For your convenience, a slightly updated version of the materials is attached.

We are also exploring opportunities to use these materials in future CLE programs delivered in partnership with state and local bar associations as part of an effort to provide regional programming to UCC Committee members. The choice to provide this type of programming regionally is a direct outgrowth of the UCC Committee survey conducted just prior to the Spring Meeting. I wish to thank each of you who responded to the survey and provide you with the survey results.

The Pitfalls program was just one of the many wonderful presentations that took place at the Spring Meeting. As always, if you are a member of the Business Law Section, but were unable to attend the Spring Meeting, you can obtain the materials for all of the UCC Committee programs as well as all of the other Spring Meeting programs free of charge at http://www.abanet.org/buslaw/apps/updatedsearch/materials.html. To obtain materials relating to a subcommittee meeting, please contact the subcommittee chairs directly.

Not surprisingly, the highlight of the 2006 Spring Meeting for me personally was the second annual “Stump the Chumps” panel. This year’s panel was superb thanks to participation by Amy Boss, Neil Cohen, Alvin Harrell, Sandra Rocks, and a last minute substitution, Fred Miller. I must also thank this year’s facilitator Stephen Sepinuck not only for his agility in handling the panel and the standing room only audience, but also for his willingness to give me one of the coveted “I Stumped the Chumps” pins even though I failed to ask a single question. We are already planning next Spring’s panel so keep those questions coming!

I also would like to briefly mention the special joint meeting on bank deposits. Specifically, I would like to thank the groups that cosponsored this event (UCC Subcommittee on Payments, Commercial Financial Services Committee, Consumer Financial Services Subcommittee on Deposit Products and Payment Systems, and Banking Law Subcommittee on Payments and Electronic Banking) and all of you who showed up and participated in the lively discussion.

Finally, let me say a word about the 2006 Annual Meeting in Hawaii. The UCC Committee will be meeting in Hawaii. If you are attending the Annual Meeting, I hope that you will join us for the following UCC Committee programming:

**UCC CHRONOLOGICAL SCHEDULE OF EVENTS**

**Saturday, August 5, 2006**

**10:30 – Noon**

**Banking on the Tigris**

Joint Meeting of the UCC Committee’s Subcommittee on Payments and the Banking Law Committee’s Subcommittee on Payments and Electronic Banking and Subcommittee on International Banking
After Baghdad fell in the Spring of 2003, the banking and financial systems of Iraq were in disarray. One of the American advisors will discuss his experiences in Baghdad as part of the effort to draft and implement laws and regulations that gave the Central Bank of Iraq the powers of an independent central bank and the continuing efforts to implement a modern electronic payment system in Iraq.

Sunday, August 6, 2006
7:00 AM – 9:00 AM

Transacting Business Over the Internet in the Asia-Pacific Rim
Cyberspace Committee and Co-Sponsored by the UCC Committee and the International Business Committee

Transacting business over the Internet in the Asia-Pacific Rim poses unique legal and political problems because of wide variations in laws and legal systems among the nations of the area. The Internet is still under development in the region, and is subject to substantially different national regulatory approaches. This Program will explore these problems through a panel discussion among practitioners from the region and experts in the field. The key elements of the Program will be: (1) Formation of agreements and relationships, (2) enforcement, (3) payment systems, (4) intellectual property protection, and (5) governmental and regulatory concerns.

Monday, August 7, 2006
8:30 AM – 10:00 AM

UCC Committee Meeting: Recent UCC Case Law Developments,

Whether you simply want to hear about the latest UCC decisions or have a UCC case that you are burning to share with the rest of the membership, please join us at the UCC Committee meeting.

I guess that leaves me with one final bit of business, and that is to announce that immediately following the 2006 Annual Meeting, Stephen Sepinuck, the current Vice Chair of the UCC Committee, will take over as Chair of the UCC Committee. And I suppose, now that my term is over, I can admit that so much of what we accomplished over the last three years was because of Stephen. If you are attending the 2006 Annual Meeting you should definitely say hello to Stephen and let him know your ideas for the Committee.

Serving as Chair for the past three years has been such an incredible privilege not to mention a tremendous amount of fun. I am so proud of this Committee and thankful to have been involved at a time when we were challenged to look beyond the drafting committees and the UCC generally and to consider instead the fluid boundaries of the Code and the interplay between the UCC and other areas of commercial practice. I cannot speak for others, but I, for one, think that we have more than lived up to this challenge. Thank you all!
In its legislative session ended June 30, 2006, the Delaware General Assembly enacted amendments to the Delaware Limited Liability Company Act, 6 Del. C. § 18-101 et seq. (the “DLLC Act”), the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. § 17-101 et seq. (the “DLP Act”), and the Delaware Statutory Trust Act, 12 Del. C. § 3801 et seq. (the “DST Act”). These amendments generally take effect on August 1, 2006, with the exception of those related to registered agents under the DLLC Act and DLP Act, which take effect on January 1, 2007.

The amendments to the DLLC Act and the DLP Act are substantially similar. Most significant, perhaps, are those relating to registered agents. The amendments define as “commercial registered agents” those registered agents serving as such for more than fifty (50) entities, and subject them to special rules. An entity (as contrasted with an individual) commercial registered agent must (i) maintain a place of business in Delaware which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. Limited liability companies and limited partnerships must provide their registered agents (and update as necessary) contact information for a natural person who is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents must maintain such information for communications contacts, and are authorized to resign if they are not provided such information. The amendments establish a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments explicitly provide that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. Certificates of formation and certificates of limited partnership may be cancelled if a limited liability company or limited partnership fails to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such.

* Norman M. Powell is a partner in the Delaware law firm Young Conaway Stargatt & Taylor, LLP, where his practice includes service as Delaware counsel to bankruptcy-remote Delaware alternative entities, delivery of perfection, priority, and other security interest opinions, and representation of trusts and trustees in financing transactions. He can be reached via email at npowell@ycst.com.
Among the more salient amendments to the DST Act are those to Section 3806 clarifying that duties (including fiduciary duties) may be expanded, restricted, or eliminated by provisions in the governing instrument, and confirming that the implied contractual covenant of good faith and fair dealing may not be eliminated. Unless otherwise provided in the governing instrument, (i) persons acting in good faith reliance on provisions of the governing instrument are not liable to the statutory trust or to persons bound by its governing instrument, and (ii) meetings of beneficial owners and trustees, respectively, may be held by means of conference telephone or other communications equipment, so long as all participants in such meeting can hear each other. Persons managing the business and affairs of a statutory trust are fully protected in relying in good faith upon the records of the statutory trust and certain information reasonably believed to be within the professional or expert competence of the person offering the same, such as financial information and reports relevant to the statutory trust’s ability to pay or make reasonable provision to pay claims and obligations. A new Section 3863 consists of a non-exhaustive list of twelve (12) things that, when done by foreign statutory trusts in the State of Delaware, do not constitute doing business in Delaware for purposes of the DST Act. They include maintaining, defending, or settling actions or proceedings, maintaining bank accounts, creating or acquiring indebtedness (whether as lender or borrower, whether secured or unsecured), collecting debts and foreclosing mortgages and other security interests, conducting isolated transactions not in the course of similar transactions, and doing business in interstate commerce.

This article summarizes these amendments to the DLLC Act (House Bill No. 414, 75 Del. Laws 317), the DLP Act (House Bill No. 415, 75 Del. Laws 414), and the DST Act (House Bill No. 445 75 Del. Laws 418).

DLLC ACT AMENDMENTS.

The DLLC Act was amended by House Bill No. 414, 75 Del. Laws 317, effective August 1, 2006 and, with respect to certain provisions relating to registered agents, January 1, 2007.

The amendment to Section 18-101(12) confirms that the term “person” is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

By far the largest of this year’s changes relate to registered agents and, generally speaking, these changes are the same in both the LLC Act and the LP Act. Section 18-104(a) expands the types of entities that may serve as registered agents, clarifying that an LLC may be its own registered agent or may have a domestic or foreign partnership (whether general or limited, and including a limited liability limited partnership) act as its registered agent. New Section 18-104(e) prescribes the duties of a registered agent, including (in the case of entities) the maintenance of a business office located in Delaware and generally open or (in the case of individuals) being present at a designated location in Delaware at sufficiently frequent times to perform the functions of a registered agent. Foreign entities acting as registered agents must be authorized to transact business in Delaware. Of course, registered agents must accept service of
process and other communications and forward them to the LLC to which such communications are directed, and similarly must forward statements for annual taxes due the State of Delaware.

New Section 18-104(f) provides that registered agents serving as such for more than fifty (50) entities (commercial registered agents) are subject to special rules. A natural person commercial resident agent must (i) maintain a principal residence or principal place of business in Delaware, (ii) maintain a Delaware business license, (iii) be generally present at a designated location in Delaware during normal business hours to perform the functions of a registered agent, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. An entity commercial registered agent must (i) maintain a place of business in Delaware (note it need not be a principal place of business) which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent.

New Section 18-104(g) requires every LLC formed or qualified to do business in Delaware to provide its registered agent (and to update as necessary) the name, business address, and business telephone number of a natural person who is a member, manager, officer, employee or designated agent of the LLC and is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents are obligated to maintain such information for communications contacts and authorized to resign if they are not provided such information with respect to communications contacts. New Section 18-104(h) authorizes the Secretary of State to issue rules and regulations to carry out the foregoing.

New Section 18-104(i) sets forth a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments provide in particular that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. This new section provides for cancellation of a certificate of formation should an LLC fail to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such, and new Section 104(j) authorizes the Secretary of State to make a list of registered agents available to the public.

Sections 18-203 and 18-206(b) have been amended to conform to new Section 18-104(i)(4) regarding cancellation of a certificate of formation.

Section 18-209(b) has been amended to correct certain words, clarifying that merger or consolidation results in a single, designated surviving or resulting entity.
Technical changes have been made to Section 18-212 regarding domestication of non-United States entities, clarifying that the term “non-United States entity” can include a statutory trust or any unincorporated business or entity. A new Section 18-212(c)(6) requires that domestication be approved in the manner provided for by the writing governing the internal affairs of the non-United States entity and the conduct of its business, or by applicable non-Delaware law, as appropriate. New text in Section 18-212(h) provides that property of a domesticated non-United States entity remains vested not only in the domestic LLC, but also in the non-United States entity, if and for so long as the non-United States entity continues its existence in the foreign jurisdiction in which it was existing immediately prior to the domestication. Section 18-213 now contains provisions with respect to continuance paralleling nearly all provisions relating to transfer or domestication. Section 18-214, relating to conversion of certain entities to LLCs, now more clearly applies to any unincorporated entity. New text in Section 18-216(c) provides that conversion of a domestic LLC to another entity or business form doesn’t constitute a dissolution of such LLC. Rather, the other entity or business form constitutes a continuation of existence of the LLC in the form of such other entity or business form.

Section 18-302(d) has been amended to clarify that meetings of members may be held by conference telephone or similar means by which all participants can hear each other, unless otherwise provided in the LLC agreement; likewise Section 18-404(d) with respect to meetings of managers.

Section 18-906 has been amended to conform to the provisions of new 18-104(i)(4) providing for cancellation of the registration of a foreign LLC in the circumstances provided therein.

Finally, Section 18-1109 has been amended to permit the revival of a certificate of formation of an LLC whose certificate of formation has been cancelled pursuant to new 18-104(i)(4).

**DLP ACT AMENDMENTS.**

The DLP Act was amended by House Bill No. 415, 75 Del. Laws 414, effective August 1, 2006 and, with respect to certain provisions relating to registered agents, January 1, 2007.

The amendment to Section 17-101(14) confirms that the term “person” is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

The amendment to Section 17-102 confirms that the name of a limited liability limited partnership must contain the designation required by Section 17-214(a) (e.g., LLLP), rather than that required by Section 17-102(a) (e.g., LP).

By far the largest of this year’s changes relate to registered agents and, generally speaking, these changes are the same in both the LLC Act and the LP Act. Section 17-104(a) expands the types of entities that may serve as registered agents, clarifying that an LP may be its
own registered agent or may have a domestic or foreign partnership (whether general or limited, and including a limited liability limited partnership) act as its registered agent. New Section 17-104(e) prescribes the duties of a registered agent, including (in the case of entities) the maintenance of a business office located in Delaware and generally open or (in the case of individuals) being present at a designated location in Delaware at sufficiently frequent times to perform the functions of a registered agent. Foreign entities acting as registered agents must be authorized to transact business in Delaware. Of course, registered agents must accept service of process and other communications and forward them to the LP to which such communications are directed, and similarly must forward statements for annual taxes due the State of Delaware.

New Section 17-104(f) provides that registered agents serving as such for more than fifty (50) entities (commercial registered agents) are subject to special rules. A natural person commercial resident agent must (i) maintain a principal residence or principal place of business in Delaware, (ii) maintain a Delaware business license, (iii) be generally present at a designated location in Delaware during normal business hours to perform the functions of a registered agent, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent. An entity commercial registered agent must (i) maintain a place of business in Delaware (note it need not be a principal place of business) which is generally open during normal business hours to perform the functions of a registered agent, (ii) maintain a Delaware business license, (iii) have present at its Delaware office during normal business hours an officer, director or managing agent who is a natural person, and (iv) upon request provide the Secretary of State certain information identifying and enabling communication with such registered agent.

New Section 17-104(g) requires every LP formed or qualified to do business in Delaware to provide its registered agent (and to update as necessary) the name, business address, and business telephone number of a natural person who is a partner, officer, employee or designated agent of the LP and is authorized to receive communications from the registered agent. Such persons are referred to as “communications contacts.” Registered agents are obligated to maintain such information for communications contacts and authorized to resign if they are not provided such information with respect to communications contacts. New Section 17-104(h) authorizes the Secretary of State to issue rules and regulations to carry out the foregoing.

New Section 17-104(i) sets forth a procedure by which the Delaware Secretary of State may apply to the Delaware Court of Chancery to enjoin any person from serving as a registered agent or as an officer, director, or managing agent of a registered agent. While the Court of Chancery has broad equitable powers, the statutory amendments provide in particular that any person or entity convicted of a felony or any crime involving dishonesty, fraud, or moral turpitude, and any registered agent who, acting as such, has engaged in conduct intended or likely to deceive or defraud the public, may be enjoined from acting as a registered agent, or as an officer, director or managing agent of a registered agent. This new section provides for cancellation of a certificate of limited partnership should an LP fail to timely obtain and designate a new registered agent following notice of an order by the Court of Chancery enjoining its registered agent from acting as such, and new Section 17-104(j) authorizes the Secretary of State to make a list of registered agents available to the public.
Sections 17-203 and 17-206(b) have been amended to conform to new Section 17-104(i)(4) regarding cancellation of a certificate of limited partnership.

Amendments to Section 17-214 confirm that a limited partnership may be formed from its inception as a limited liability limited partnership.

Technical changes have been made to Section 17-215 regarding domestication of non-United States entities, clarifying that the term “non-United States entity” can include a statutory trust or any unincorporated business or entity. A new Section 17-215(c)(6) requires that domestication be approved in the manner provided for by the writing governing the internal affairs of the non-United States entity and the conduct of its business, or by applicable non-Delaware law, as appropriate. New text in Section 17-215(h) provides that property of a domesticated non-United States entity remains vested not only in the domestic LP, but also in the non-United States entity, if and for so long as the non-United States entity continues its existence in the foreign jurisdiction in which it was existing immediately prior to the domestication. Section 17-216 now contains provisions with respect to continuance paralleling nearly all provisions relating to transfer or domestication. Section 17-217, relating to conversion of certain entities to LPs, now more clearly applies to any unincorporated entity. New text in Section 17-217(b) clarifies that an other entity may convert not only to a domestic limited partnership, but to a limited liability limited partnership as well. New text in Section 17-219(c) provides that conversion of a domestic LP to another entity or business form doesn’t constitute a dissolution of such LP. Rather, the other entity or business form constitutes a continuation of existence of the LP in the form of such other entity or business form.

Section 17-302(e) has been amended to clarify that meetings of limited partners may be held by conference telephone or similar means by which all participants can hear each other, unless otherwise provided in the partnership agreement; likewise Section 17-405(d) with respect to meetings of general partners.

Section 17-906 has been amended to conform to the provisions of new 17-104(i)(4) providing for cancellation of the registration of a foreign limited partnership in the circumstances provided therein.

Finally, Section 17-1111 has been amended to permit the revival of a certificate of limited partnership of a limited partnership whose certificate of limited partnership has been cancelled pursuant to new 17-104(i)(4).

DST ACT AMENDMENTS.

The DST Act was amended by House Bill No. 445, 75 Del. Laws 418, effective August 1, 2006.

Text inadvertently deleted by a prior amendment has been restored to Section 3801(a), which once again provides that a statutory trust may be organized to carry on any lawful business or activity, regardless of profit motive, including holding or otherwise taking title to property.
The amendment to Section 3801(d) confirms that the term “person” is to be construed broadly, and includes governmental entities, subdivisions, agencies and instrumentalities, and various organizations and entities, including series thereof.

Revisions to Section 3801(f) confirm that beneficial owners and trustees are bound by governing instruments regardless of whether or not they execute them.

Sections 3804(h) and 3852(b), relating to doing business in Delaware, have been deleted, such matters now being covered by new Section 3863 (discussed below).

Section 3806, relating to management, has been amended in several respects. Section 3806(c) clarifies that the duties (including fiduciary duties) of a trustee, beneficial owner, or other person party to or otherwise bound by a governing instrument may be expanded, restricted, or eliminated by provisions in the governing instrument, and confirms that the implied contractual covenant of good faith and fair dealing may not be eliminated thus. Section 3806(d) clarifies that unless the governing instrument provides otherwise, a trustee, beneficial owner, or other person acting in good faith reliance on the provisions of the governing instrument shall not be liable to the statutory trust or to another trustee, beneficial owner, or other person who is bound by such governing instrument. New Section 3806(e) permits a governing instrument to provide for limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a trustee, beneficial owner, or other person to a statutory trust or to another trustee, beneficial owner, or other person who is bound by such governing instrument, with the proviso that the governing instrument may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. Former Sections 3806 (e) and (f) (now (f) and (g)) provide that, unless otherwise provided in the governing instrument, meetings of beneficial owners and trustees, respectively, may be held by means of conference telephone or other communications equipment, so long as all participants in such meeting can hear each other. New Section 3806(k) provides that any person designated in accordance with subsection (b)(7) (to manage the business and affairs of the statutory trust) shall be fully protected in relying in good faith upon the records of the statutory trust and certain information reasonably believed to be within the professional or expert competence of the person offering the same, and includes specifically information, opinions, reports or statements as to the value and amount of the assets, liabilities, profits or losses of the statutory trust and other matters relevant to its ability to pay or make reasonable provision to pay claims and obligations.

Section 3807(b)(2), which applies to certain statutory trusts that are or are to become registered investment companies, now permits limited partnerships, limited liability companies, and statutory trusts to act as registered agents for such statutory trusts.

Sections 3808 (c) and (e) and 3810(a)(2) now permit beneficial owners to vote to continue the existence of a statutory trust notwithstanding provisions of the governing instrument providing for dissolution, require that the winding up of a statutory trust include making reasonable provision to pay not only claims known to the trust but also for claims that, based on facts known to the statutory trust, are likely to arise or to become known to the statutory trust.
within ten years after the date of dissolution, and clarify that the existence of a statutory trust as a separate legal entity continues until cancellation of its certificate of trust.

Technical changes to Sections 3820 (a) and (f) and 3822(i) relate to conversion of an entity into a statutory trust and domestication of non-United States entities.

Changes to Section 3823(b) are intended to confirm the flexibility permitted under the DST Act with respect to transfer, domestication, and continuance of statutory trusts, setting forth a hierarchy of applicable rules. If a governing instrument specifies the manner of authorizing a transfer, domestication, or continuance, such manner shall be observed. If it does not, and does not prohibit such transfer, domestication, or continuance, the transfer, domestication, or continuance shall be authorized in the same manner as is specified in the governing instrument for authorizing a merger or consolidation. If the governing instrument does not specify the manner of authorizing a merger or consolidation and does not prohibit transfer, domestication, or continuance, the transfer, domestication, or continuance shall be authorized by approval of all beneficial owners and all trustees.

Section 3863 is new, and consists of a list (not purporting to be exhaustive) of twelve (12) things that, when done by foreign statutory trusts in the State of Delaware, do not constitute doing business in Delaware for purposes of the DST Act. They include maintaining, defending, or settling actions or proceedings, maintaining bank accounts, creating or acquiring indebtedness (whether as lender or borrower, whether secured or unsecured), collecting debts and foreclosing mortgages and other security interest, conducting isolated transactions not in the course of similar transactions, and doing business in interstate commence.
SPEARING AND PLANNED FURNITURE OR: WHAT COMES AROUND GOES AROUND FOR THE IRS

By

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Two recent decisions inject uncertainty into the orderly logic and process of UCC searches, leaving creditors in a conundrum over how to best protect the priority of their security interests.

1. Spearing Tool and Manufacturing Co., Inc.: IRS Law Trumps the UCC

Many of us were shocked by the recent law enunciated by the Sixth Circuit in its decision issued on June 21, 2005, In re: Spearing Tool and Manufacturing Co., Inc., 412 F.3d 653 (6th Cir. 2005). In this case, the bankruptcy court had held that the IRS does not have to follow the equivalent of the Uniform Commercial Code (UCC) debtor-name rules when filing a tax lien and that Crestmark Bank and Crestmark Financial Corporation (collectively, Crestmark), although unable to find an IRS lien filed under a name that could not be found in a UCC search using the ‘correct’ debtor name, was nevertheless junior to the IRS. The district court reversed and held for Crestmark. The Sixth Circuit reversed the district court and affirmed the bankruptcy court’s grant of summary judgment for the government.

The facts of the Spearing decision are straightforward: in April 1998, Spearing Tool and Manufacturing Co. (“Spearing” or “debtor”) and appellees Crestmark entered into a lending agreement that granted Crestmark a security interest in all of Spearing’s assets. Crestmark perfected its security interest by filing a UCC financing statement, identifying the debtor Spearing as “SPEARING TOOL & MFG. COMPANY INC.,” the exact name registered with the Michigan Secretary of State. In April 2001, Spearing entered into a secured financing arrangement with Crestmark providing for Crestmark’s purchase of accounts receivable from Spearing and Spearing’s grant to Crestmark of a security interest in all its assets. Crestmark perfected its security interest by filing another UCC financing statement, again using Spearing’s precise name registered with the Michigan Secretary of State.

Spearing fell behind in its federal employment tax payments. On October 15, 2001, the IRS filed two notices of federal tax lien against Spearing with the Michigan Secretary of State. Each IRS lien identified Spearing as “SPEARING TOOL & MFG. COMPANY INC.,” which varied from Spearing’s name registered in Michigan because
it used an ampersand in place of “and,” abbreviated “Manufacturing” as “Mfg.,” and spelled out “Company” rather than use the abbreviation “Co.” The name on the IRS lien notices was the name Spearing used on its quarterly federal tax return for the third quarter of 2001 as well as its return for the fourth quarter of 1994—the first quarter for which Spearing was delinquent. For most of the other relevant tax periods, Spearing filed returns as “Spearing Tool & Manufacturing”—neither its name registered in Michigan nor the name on the IRS tax liens. Crestmark periodically submitted lien search requests to the Michigan Secretary of State, using Spearing’s name registered in Michigan. Because Michigan has an “exact match” standard search logic, which is permitted by UCC Article 9, searches in Michigan disclose only liens matching the precise name used by the searcher—not liens such as the IRS lien that are filed under slightly different or abbreviated names. Crestmark’s search results in February 2002 came back from the Secretary of State’s office with a handwritten note stating: “You may wish to search using Spearing Tool & Mfg. Company Inc.” Crestmark chose not to search for that name at that time, and its exact-registered-name searches did not reveal the IRS liens. As a result, Crestmark was unaware of the IRS liens and advanced more funds to Spearing between October 2001 and April 2002.

On April 16, 2002, Spearing filed a chapter 11 petition in bankruptcy court. After the bankruptcy filing, Crestmark did a UCC search for “Spearing Tool & Mfg. Company Inc.” and discovered the IRS lien filings. Crestmark then filed a complaint to determine the priority of liens between it and the IRS. The bankruptcy court decided that the IRS lien had priority; and the U.S. district court reversed. The IRS appealed that decision to the Sixth Circuit Court of Appeals and asked the court to decide whether state or federal law determines the sufficiency of the IRS’s tax-lien notices and whether the IRS notices gave sufficient notice to give the IRS liens priority over the Crestmark liens.

The Sixth Circuit reasoned that, when the IRS files a lien against a taxpayer’s property, it must do so “in one office within the State . . . as designated by the laws of such State, in which the property subject to the lien is situated.” 26 U.S.C. § 6323(f)(1)(A). The Internal Revenue Code provides that the form and content “shall be prescribed by the [U.S. Treasury] Secretary” and “be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.” (emphasis added by the Court). 26 U.S.C. § 6323(f)(3) Regulations provide that the IRS must file tax lien notices using IRS Form 668, which must “identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose.” 26 C.F.R. § 301.6323(f)-1(d)(2). Form 668 notice “is valid notwithstanding any other provision of law regarding the form or content of a notice of lien. For example, omission from the notice of lien of a description of the property subject to the lien does not affect the validity thereof even though State law may require that the notice contain a description of property subject to the lien.” § 301.6323(f)-1(d)(1).

The Court held that the plain text of the statute and regulations indicates that a Form 668 notice suffices, regardless of state law, and concluded that it need only consider how much specificity federal, not state, law required for taxpayer identification.
on tax liens. Finding that an IRS tax lien need not perfectly identify the taxpayer, the court of appeals concluded that IRS notice was sufficient.

The critical issue for the Sixth Circuit in determining whether an abbreviated or erroneous name sufficiently identifies a taxpayer was whether a “reasonable and diligent search would have revealed the existence of the notices of the federal tax liens under these names.” Crestmark argued that the question for the Sixth Circuit was whether Crestmark conducted a reasonable and diligent electronic search, and the Court found that it did not. The Court decided that Crestmark should have searched for “Spearing Tool & Mfg.” as well as “Spearing Tool and Manufacturing,” and concluded that “Mfg.” and the ampersand were very common abbreviations that courts use in case citations. In fact, Crestmark had notice that Spearing sometimes used such abbreviations, and the Michigan Secretary of State’s office recommended that Crestmark do a search using these abbreviations. These facts indicated to the court of appeals that a “reasonable, diligent search” by Crestmark, of the Michigan lien filings for this business, would have disclosed Spearing’s IRS tax liens, even though that may not be the standard in Revised Article 9.

Crestmark argued for requiring multiple searches by offering the extreme example of a name it claims could be abbreviated 288 different ways was unreasonable—“ABCD Christian Brothers Construction and Development Company of Michigan, Inc.” The Court found that the only two relevant words that could be, and commonly are, abbreviated are “Manufacturing” and “and”; and the Michigan Secretary of State specifically recommended searching for those abbreviations. The Secretary of State’s recommendation seems to have been a decisive factor. The Court expressly refused to decide whether creditors have a general obligation to search name variations and limited its holding to the facts in the Spearing case.

The Court also noted that policy considerations support the IRS’s position: a requirement that tax liens identify a taxpayer with absolute precision would be unduly burdensome to the government’s tax-collection efforts. Such a requirement might burden the government at least as much as Crestmark claimed it would have been a burden to perform multiple lien searches. To subject the federal government to different identification requirements—varying with each state’s electronic-search technology—“would run counter to the principle of uniformity which has long been the accepted practice in the field of federal taxation.”

Crestmark urged the Sixth Circuit to require IRS liens to meet the same precise identification requirements that other lien notices must meet under Article 9, but the Court declined to do so. The Court reasoned that the UCC applies to transactions “that create[] a security interest in personal property or fixtures by contract.” Mich. Comp. Laws § 440.9109(1)(a) (emphasis added by the Court). As a result, the IRS would be exempt from UCC requirements even without the strong federal policy favoring unfettered tax collection. Moreover, the U.S. Supreme Court has already ruled that the United States, as an involuntary creditor of delinquent taxpayers, is entitled to special priority over voluntary creditors. Even though the Sixth Circuit understood that a
requirement that the IRS comply with UCC Article 9 would spare Crestmark considerable inconvenience, the Court concluded from the Supreme Court’s decision that the federal government’s interest in prompt, effective tax collection trumps the Crestmark’s convenience in loan collection.

The result of the Spearing decision is (1) the UCC rules are irrelevant to the effectiveness of the content of an IRS notice of lien, (ii) it is “burdensome” to impose UCC requirement on the IRS, (iii) the searcher has to search all reasonable alternatives to the debtor’s name (including those based on facts that only a particular searcher might know that would yield legal different results for different searchers), and (iv) public policy dictates that IRS tax collection should not be burdened by the strictures of the UCC because of the importance of collecting taxes. The Court read into Revised Article 9 a standard of the “reasonably prudent searcher”—a standard that may have existed under Former Article 9 and that the drafters aimed to get rid of under Revised Article 9 by using the “exact match” standard to determine effective financing statements.

The standard search logic in most states will not find a filing that does not have the debtor’s correct name (except for “noise words”). Searchers have only two effective alternatives: (1) the searcher will have to devise name variations for the debtor and make multiple searches in order to find IRS liens, which may involve some luck to create the appropriate abbreviations or (2) purchase one of the UCC9 insurance products presently offered by various title companies to shift the risk created by the Spearing case to the insurance company.¹

2. **Planned Furniture: UCC Trumps IRS Filing**

   The court in the Planned Furniture case is yet another example of courts rejecting Revised Article 9’s uniform, strict perfection rules. Planned Furniture Promotions, Inc., Plaintiff v. Benjamin S. Youngblood, Inc., d/b/a/ Honey Creek Home Furnishings; Benjamin S. Youngblood; Laura Youngblood; Citizens Bank of Fort Valley, Georgia; United States Internal Revenue Service; State of Georgia Department of Revenue, Defendants, 374 F.Supp. 1227 (M.D. Ga. 2005). The result is a strange mixture of barnyard justice and “go look for yourself” collateral monitoring. The case appears to ignore the perfection rules of Revised Article 9 with respect to the sufficiency of collateral descriptions or the legal exactness of the debtor’s name. It is ironic that the IRS loses because of the court’s failure to enforce the strict requirements of Revised Article 9.

   The decision of the United States District Court for the Middle District of Georgia, Macon Division disposed of cross motions for summary judgment filed by Planned Furniture Promotions, Inc. and the IRS in an interpleader action in which the parties claimed entitlement to $110,632.24, proceeds from the liquidation of a defunct

¹ *Editor’s Comment*: The author is general counsel to First American Corporation, one of several title companies which offer UCC9 insurance coverage. The purpose of this article is to alert the reader to recent developments in the law and the ABA is not endorsing any particular product or company.
business. The IRS also moved for summary judgment on its cross-claim against Citizens Bank of Fort Valley, Georgia (the “Bank”).

The facts of the case are relatively simple. On February 4, 1999, Benjamin and Laura Youngblood obtained a $500,000 secured loan from Bank of Fort Valley, Georgia, which took a security interest in “all inventory, accounts, furniture, fixtures, equipment, all assets now or hereafter acquired of Old Salem Furniture located at 3565 Hwy 205, Conyers, GA & any other location where business is transacted.” The Youngbloods used the proceeds of the bank loan to purchase the collateral specified in the security agreement, and the Bank obtained a purchase money security interest that was perfected by the filing of UCC-1 a financing statement on February 22, 1999. Both the security agreement and the financing statement listed the debtors as Benjamin Scott Youngblood and Laura B. Youngblood.

The Youngbloods incorporated their furniture business on February 25, 1999, as “Benjamin S. Youngblood, Inc.” The Bank was not informed of the incorporation, and the financing filed by the Bank in conjunction with the Youngbloods’ loan was never updated to indicate the change. The IRS assessed deficiencies against Benjamin S. Youngblood, Inc., for $106,743.53 in unpaid federal employment taxes for the fourth quarter of 2000, all quarters of 2001, and the first quarter of 2002. To protect the validity of its statutory lien interest, the IRS filed five Notices of Federal Tax Liens against Benjamin S. Youngblood during the period from March 11, 2002, through October 21, 2002.

The IRS filed a cross-complaint against the Bank seeking disgorgement of certain liquidation proceeds paid to the Bank before the initiation of the interpleader action. The IRS contended that its federal tax lien against the proceeds had priority over the security interest asserted by the Bank in the same proceeds and sought turnover for the tortiously converted proceeds. The Bank challenged the IRS claim for disgorgement on the grounds that its perfected security interest was superior to the federal tax lien.

In its summary judgment motion, the IRS argued (1) that any security interest obtained by the Bank in 1999 was never perfected because the financing statement inadequately described the collateral and (2) that, if the Bank's interest was initially perfected, it became unperfected four months after the Youngbloods' furniture business was incorporated because the filed financing statement was never amended to reflect the debtor's subsequent name change. This article will not consider the issue of adequate collateral description, but will rather consider the more important issue of the debtor name.

Before determining whether the IRS or the Bank had a superior priority status, the Court first decided whether a valid lien or security interest ever attached to the proceeds. The Court had no difficulty holding that the United States held a valid federal tax lien on the sale proceeds. The Court also found that, at the time the Bank loaned money to the Youngbloods in 1999, it acquired an enforceable security interest in all of the furniture store's inventory and other assets. To ensure the priority of its security interest as against
third parties, the Bank perfected its interest by filing a UCC-1 financing statement on February 22, 1999. The financing statement listed the debtors as Benjamin Scott Youngblood and Laura B. Youngblood.

Holding that the IRS's federal tax lien and the Bank's security interest were both valid, the Court then proceeded to determine which interest had priority. In order for the Bank's claim to the liquidation proceeds to have priority over the federal tax lien, it must have held a § 6323 "security interest" on March 11, 2002—the date on which the IRS filed its first Notice of Tax Lien. To qualify under the statute, the Bank had to show "(1) that the security interest was acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying loss; (2) that the property to which the security interest was to attach was in existence at the time the tax lien was filed; (3) that the security interest was, at the time of the tax lien filing, protected under the state law against a judgment lien arising out of an unsecured obligation; and (4) that the holder of the security interest parted with money or money's worth."

The IRS argued that it was entitled to summary judgment for two reasons. First, the Bank's security interest was never perfected because its financing statement failed to describe adequately the collateral. Second, even if the collateral description was adequate, the Bank's security interest became unperfected when the financing statement was not amended to reflect the incorporation of the Youngbloods' furniture business. The Court correctly observed that, in order to perfect a security interest in a debtor's collateral, a financing statement must provide the name of the debtor. As long as the name of the debtor is included in the financing statement, it is effective "even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading." O.C.G.A. § 11-9-506(a). If a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with subsection (a) of Code Section 11-9-503, the name provided does not make the financing statement seriously misleading. O.C.G.A. § 11-9-506(c). If a debtor's name change does make the financing statement seriously misleading and the change is not corrected by amendment, then the financing statement "is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change." O.C.G.A. § 11-9-507(c)(2). The IRS argued that the change in the debtor's name rendered the Bank’s financing statement seriously misleading and therefore ineffective to perfect a security interest with respect to any collateral acquired by the debtor more than four months after the change. See O.C.G.A. §11-9-508(c)(2) ("The financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the [debtors name] change, unless and amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the change."). The Court relied on § 11-9-508(c)(2) on the correct assumption that the incorporation of the Youngbloods’ furniture businesses as Youngblood, Inc., resulted in Youngblood, Inc., being a “new debtor” as defined in UCC § 9-102(56). See Official Comment 2 to § 9-508.
Section 9-508 (a) provides that a financing statement filed against an original debtor is effective to perfect a security interest in collateral in which the new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral. A “new debtor” is defined in § 9-102(56) as a person that becomes bound as debtor under § 9-203(d) by a security agreement previously entered into by another person. Section 9-203(d) completes the thought by providing that a person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than Article 9 or by contract (1) the security agreement becomes effective to create a security agreement in the person’s property or (2) the person becomes generally obligated for the obligations of the other person, including the obligations secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

The exception to the general rule of § 9-508(a) is set forth in § 9-508(b), which provides that, if the difference between the name of the original debtor and the new debtor causes a filed financing statement that is effective under subsection (a) to be seriously misleading. If the filed financing statement is seriously misleading, the secured creditor has a four-month grace period within which to file an initial financing statement against the new debtor in order to maintain perfection.

The Court stated that courts applying the UCC in Georgia recognize that a financing statement becomes seriously misleading when the names of the debtors are completely dissimilar. If a filing was sufficient to put a creditor on notice of other potential security interests, it was not seriously misleading. To the Court, a corollary to the rule of complete dissimilarity was that a financing statement is not seriously misleading where, as here, the debtor's changed name is only nominally different from the debtor's name as originally listed. One of the debtors listed on the Bank's financing statement was "Benjamin Scott Youngblood." The debtor subsequently changed his business structure by incorporating under the name "Benjamin S. Youngblood, Inc." Given this foundation, the Court than stated that the IRS now claimed that the Bank's security interest, perfected long before the federal tax lien arose, in the collateral of Benjamin Scott Youngblood (his furniture store's inventory and other assets) had lost its perfected priority status with regard to the collateral of Benjamin S. Youngblood, Inc.

As a matter of law, the Court declined to conclude that this name change rendered the original financing statement seriously misleading under O.C.G.A. § 11-9-506, reasoning that a search of the filing records under the name "Benjamin S. Youngblood, Inc." would have almost assuredly turn up a financing statement filed under the name Benjamin Scott Youngblood. Given that remarkable observation, the Court considered it reasonable to conclude that the proverbial diligent creditor searching the filing records under the name Benjamin S. Youngblood, Inc., would be put on notice to inquire into the interests of a debtor listed as Benjamin Scott Youngblood. As a result, the name change could not be considered seriously misleading. Accordingly, the Court decided that the Bank's security interest remained perfected at all times, and the IRS's motion for summary judgment was denied.
It is this author’s opinion that the Court was wrong in that it failed to consider how the UCC filing office in Georgia actually functions. The filing authority for financing statements in the State of Georgia is the Office of the Superior Court Clerk’s Cooperative Authority, a central amalgamation of county filing offices following the enactment of Revised Article 9. This office maintains two separate and distinct registries—one for individuals and one for entities. Any search for Youngblood, Inc., would not find Benjamin Scott Youngblood or Laura B. Youngblood or any other individual for that matter. A searcher, to be really reasonable and really prudent and meet the test set down by the Court, would have to search two totally distinct registries. It seems unlikely, indeed unfathomable, that searching two very separate registries is required under UCC § 9-506(c).

The result of the Court’s logic is that when searching the records for UCC filings against a corporation, limited liability company, or any other entity, the searcher, to be reasonable and prudent, one must also search the registry for individuals with similar names. If one lends to Harris Plumbing, Inc., then one should search Harris and Plumbing as possible last names. This case seems at odds with the search methodology contained in Revised Article 9 and the drafters’ intent. Filings under both former Article 9 and Revised Article 9 were to be indexed in the correct name of the debtors so that they could be located with minimal guesswork by subsequent searchers.

Two wrongly decided cases do not make a right. However, in a holistic sense, the IRS won for the wrong reasons in *Spearing* and lost for the wrong reasons in *Planned Furniture*. Maybe that’s fair.
Federal Capital Tax Elimination – Implication for Cross-Border Securitization

by Martin Fingerhut

Canada has repealed the federal capital tax. The elimination of this tax will facilitate the cross-border securitization of various classes of Canadian leases and interest-bearing receivables on a tax efficient basis. This results from the interplay between Canadian withholding tax on the one hand, and provincial capital taxes on the other.

Canada’s withholding tax regime creates a significant hurdle to securitizing leases or interest-bearing receivables in foreign capital markets. Subject to several exceptions, a 25% withholding tax applies to interest or rent paid to non-residents. Although this rate is often reduced by treaty, it rarely falls below 10%, and generally renders an off-shore securitization uneconomic.

Notwithstanding the current withholding tax regime, it has been possible to structure cross-border securitizations of interest-bearing Canadian loans free of withholding tax if the loans satisfy the three criteria of a statutory withholding tax exemption:

- The borrower is a corporation or partnership having only corporate partners;
- With limited exceptions (including acceptable events of default), mandatory repayments in the first five years do not exceed 25% of the amount of each loan;
- The parties are unrelated and act at arms-length.

It has also been possible to adapt this long-term corporate debt exemption to structure off-shore securitizations for trusts and short-term loans without attracting withholding tax:

- In one transaction, a Canadian special purpose corporation (SPV) purchased a revolving pool of floorplan loans, and issued 5-year notes to US investors.
- In another, a Canadian SPV borrowed 5-year funds from a UK commercial paper conduit and on-lent the proceeds to a Canadian securitization trust.

1 The author is the current chair of the Securitization and Derivatives Subcommittee of the ABA-BLS Commercial Financial Services Committee.
These structures faced a number of complex issues, including the Canadian tax authority’s policies with respect to back-to-back loans, tax minimization at the Canadian SPV level, and the desire to achieve off-balance sheet funding.

While these structures allow corporate loans to be securitized cross-border without withholding tax, they have not been used for leases or consumer assets. This stems from a “capital tax” imposed by certain provinces and, until recently, the federal government. This tax applies to the liabilities and capital of most corporations, but is offset by an allowance for a corporation’s holdings of loans made to other corporations. It is for this reason that capital tax applies when a Canadian SPV obtains off-shore funding to finance leases or consumer loans, but not where the securitized assets comprise solely corporate loans.

With the elimination of the federal capital tax, only provincial capital need be considered. Some provinces do not impose this tax; in others it ranges from .3% to .6%. However, a corporation will only be subject to a provincial capital tax if it has a “permanent establishment” in that province, which will generally depend on the location of its head office, other business locations, and certain types of employees and agents (including some categories of servicers). If a servicer or other agent is an independent person acting in the ordinary course of its own business (i.e. a true third party servicer), its presence in a particular province does not generally create a permanent establishment of the principal. Depending on the facts of a particular securitization, it should be possible to design an SPV so that its only permanent establishment is in a province that does not impose capital tax. By doing so, it would be possible to structure a cross-border securitization of pools of leases or non-corporate loans (such as auto loans, residential mortgages, credit card receivables and loans to REITS) on a basis that avoids both withholding tax and capital tax.

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Borrower's Rights in Agricultural Collateral—Fundamental Concepts and Recent Contradictions

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In order for a security interest to attach to collateral, the Debtor must have, “rights in the collateral or the power to transfer rights in the collateral to a third party.” UCC 9-203(b)(2). This fundamental principle is frequently litigated in the agricultural finance arena as borrowers arrange for the purchase and raising of agricultural products under a variety of circumstances and contractual devices. When the parties do not fully understand the concept of rights in the collateral or the underlying facts, lenders who seek to realize upon their collateral may find themselves in a dispute with their borrowers or other parties.

The phrase “rights in the collateral” has never been defined in the UCC. The courts often state the obvious—that it means something greater than mere possession or the right to possession. Thus, the party with only possession and no other rights does not have sufficient rights to grant a security interest to a lender. However, possession by a Debtor is not necessary if other rights in the collateral exist. In other words, the owner of the goods can use them as collateral, even if he or she does not have possession. Kunkel v. Sprague National Bank, 128 F. 3d 636 (8th Cir. 1997).

Courts have consistently stated that a Debtor does not need good or full title in order for its lender’s security interest to attach. See, for example, Border State Bank v. Bagley Livestock Exchange, 690 N.W. 2d 326 (Minn. App. 2004) (rights in calves under cattle-sharing agreement are sufficient “rights” for purpose of granting security interest). For an interesting glimpse into the types of cooperative agreements which provide the basis for rights in collateral litigation, the Cattle Agreement from Border State Bank is attached. In some contexts, title is considered irrelevant in article 9 priority matters. But beyond these basic areas of agreement, the courts differ significantly in how they determine whether a borrower has sufficient rights in the collateral when issues such as bailment, consignment and partial ownership are involved.

UCC §1-201(36) states that “rights” include remedies with respect to the collateral. For example, if the Debtor could reclaim goods following a sale for which it was not paid, or if a Debtor could replevy goods following wrongful disposition, he would seem to have rights sufficient for attachment. B. Clark, The Law of Secured Transactions under the Uniform Commercial Code, Rev. Ed., ¶2.04 The secured creditor sometimes can look to UCC Article 2 to determine the Debtor’s rights to goods used as collateral. For example, it seems that a Debtor has rights in goods he purchased from a retailer, but which had not yet been delivered to him. See UCC §2-501(1)—a buyer obtains a special property and an insurable interest in goods by identification of existing goods to a sale contract.

However, a Debtor who accepts property as a bailee, for example for the limited purpose of repairing it, could not successfully pledge the goods as inventory to a lender. A mere bailee, although he has possession, lacks sufficient rights to grant a security interest. Rohweder v. Aberdeen Production Credit Assoc., 765 F.2d 109 (8th Cir. 1985).

Cases construing “rights in the collateral” in an agricultural finance setting generally involve situations where the Debtor’s rights are something less than full ownership rights. In those cases, courts struggle to reconcile the rights of the Debtor
against third party rights. The concepts discussed in these agricultural type cases tend to fall into at least three categories:

1. Cases where the Debtor’s acquired the collateral from one who had imperfect or non-existent rights, such as where the property was stolen from or converted by another. These cases frequently involve the concept of “voidable title.”

2. Cases involving a bailment, consignment or entrustment of property and the claim of the bailee or consignee’s lender that it has a security interest in those goods or in related contract rights. In these cases, the courts sometimes have difficulty distinguishing a bailment from other possessory rights. Closely analogous to the bailment cases are those relating to entrustment. Suppose an equipment owner loans or leases a piece of equipment to farmer. The blanket lien of farmer’s lender cannot trump the rights of the equipment owner. Under UCC§2-403(2) only a “buyer in the ordinary course of business” can defeat the equipment owner’s rights to the equipment.

3. Rights in the Collateral by “estoppel” is also a common theme, where courts deny ownership rights to a particular party which, having an opportunity to make known its ownership interest or security interest in collateral, failed to do so, to the prejudice of others.

Also relevant to the discussion are cases dealing with a farmer’s rights to government payments. Although government payments are generally not considered rights in the agricultural products, the same issues relating to who owns the rights to the payment arise in various contexts.

This paper will discuss cases (organized by type of collateral) dealing with each of these issues, along with rights in the collateral generally in the agricultural finance context.

Livestock Cases

Cases involving cattle or hogs are a fertile ground for litigation over what constitutes rights in the collateral. A common theme in these cases is that the parties do not have written contracts or if they do, the contracts leave important issues unanswered. In such cases, the courts tend to look at characteristics of ownership in determining whether one party or another has rights in the collateral. These characteristics include:

1. Who has or has had possession;
2. Who has the right or the power to sell;
3. Whether a particular party is an agent or a principal;
4. What third parties would see if they could inspect or observe the collateral in terms of how rights in the collateral are exercised by the Debtor;
5. The intention of the parties as expressed in their contract or dealings.

In *Kunkel v. Sprague National Bank*, 128 F. 3d 636 (8th Cir. 1997) the Eighth Circuit held that a Debtor/cattleman had rights in the collateral even though he never took possession of cattle that he purchased from a feedlot operator. The feedlot operator financed the Debtor/cattleman’s purchase of the cattle, and then retained possession under a cattle feeding contract. Decisions as to when the cattle were to be sold belonged, by contract, to the Debtor/cattleman. In reversing lower bankruptcy court and district court opinions, the Eighth Circuit held that even though he never took delivery or possession of the cattle, the Debtor/cattleman had sufficient rights in the livestock to grant a security interest in them to his bank. The feedlot operator was a bailee of the cattle owned by the Debtor/cattleman. See also, *First National Bank in Munday v. Lubbock Feeders L.P.*, 2006 WL 60812, ___ S.W. 3d ___ (Tex. App. 2006) (copy of case attached)

In *Border State Bank v. Bagley Livestock Exchange*, 690 N.W. 2d 326 (Minn. App. 2004), the Debtor agreed to care for and breed cattle owned by another—Johnson. Their agreement provided that the cattle placed with Debtor were “considered to be owned by Johnson” and Johnson would receive a guaranteed percentage of the calf crop. The remaining proceeds of the calf crop would be paid to Debtor “for his keeping of the cattle.” This is typical of deals in the cattle industry, where cattlemen “partner” or share in the proceeds or offspring according to some formula. A copy of the Cattle Agreement is attached.

Although the exact terms of the cattle-sharing agreement changed over time, it was still being performed when Debtor obtained a loan from Border State Bank and granted as collateral all of his “rights, title and interest” in livestock then owned or thereafter acquired. When Debtor encountered financial problems, Johnson took back his cattle and left some calves with Debtor. Thereafter, the nearly 300 calves that had remained with Debtor were sold by the Bagley Livestock Exchange. The Bagley Livestock Exchange paid the proceeds to Johnson after talking with him about the nature of the contract. Border State Bank sued the Bagley Livestock Exchange and Johnson, claiming conversion. At trial, it appears that the parties argued about “ownership” of the cattle, but neglected to mention “rights in the collateral.” The trial court directed a verdict against Border State Bank.

The Minnesota Court of Appeals reversed, holding that Debtor had sufficient rights in the calves to grant a security interest in them, even though he may not have held “title” or “ownership” in them. “Mere possession” of the collateral is insufficient to support attachment of a security interest, but the Debtor need not have full ownership, said the court. Id at 333. “The common conceptualization of property rights as consisting of a bundle of sticks is helpful in understanding when a Debtor has sufficient rights in an asset to grant an enforceable Article 9 security interest.” The court remanded the case for determination of the Debtor’s rights under the cattle-sharing contract.
Along similar lines is Brown v. United States, 622 F. Supp. 1047 (D.S.D. 1985). In that case, Brown entered into an oral agreement to fund the purchase of cattle by the Debtor, who had a pre-existing security agreement with the FmHA, in which he had granted FmHA a security interest in all livestock, including after-acquired. The oral agreement provided that Brown would put up the money for fifty head of cattle; the Debtor would purchase the cattle and re-sell them at a higher price. After Brown was re-paid the purchase price, he and the Debtor would split the profit. The cattle were initially segregated, but later commingled with other cattle of the Debtor. When Debtor defaulted on his loans to FmHA, that lender liquidated the cattle for repayment of the debt. Upon learning that his cattle were gone, Brown sued to recover based on conversion. The South Dakota U.S. District Court found that Debtor had sufficient rights in the cattle for FmHA’s security interest to attach. The court rejected Brown’s claim that the Debtor was a mere bailee, since the Debtor had dealt with the cattle as more than a bailee, and treated them as if they were his own. The court also rejected the idea that Brown had any claim superior to that of FmHA to the cattle or the proceeds. Thus, in this case, even though the Debtor’s “rights” in the collateral were limited (he had a right only to one-half the profits, according to his agreement with Brown) his lender’s security interest attached to the cattle as if Brown had full ownership. Noting the harsh result, the court reminded the parties that Brown need only have complied with the purchase money security interest provisions of the UCC in order to have protected himself.¹

Those two cases, in which a contractual right is construed as a right to the livestock, can be contrasted with Central Production Credit Association v. Hopkins, 810 SW 2d 108 (Mo. App. 1991). In that case the court found that a Debtor who never took possession or became entitled to possession of 88 head of cattle that he had agreed to buy from a livestock auction did not have sufficient rights in the cattle for his lender’s security agreement to attach. The problem for the Debtor’s lender was that although the Debtor had won the bid for eighty-eight head of cattle during various auctions over a four-week period, he had not written the checks for them yet, and by agreement with the seller the cattle were to be held by a third party and title was not to pass until the Debtor paid for them. When the Debtor defaulted on his debt to the PCA, the PCA sued the livestock auction house, claiming the cattle were its collateral. The court held that having not paid for the cattle, the Debtor did not acquire sufficient rights in the collateral in order for the PCA’s security interest to attach.

More recently, the South Dakota Supreme Court struggled with the rights of conflicting ownership claims to cattle in American Bank & Trust v. Shaull, 678 N.W. 2d 779 (S.D. 2004). Shaull owned a livestock auction house in South Dakota, which bore the name “H.S. Cattle.” In addition, he owned livestock of his own on other South Dakota land. In 2001, he granted his lender, American Bank & Trust (“American Bank”) a security interest in livestock, farm products and inventory. His lender did not know he did business as H.S. Cattle. Of course, it takes a third party to create a dispute in this now familiar fact setting. Enter Feldman, a Minnesota cattle feeder. Feldman’s contract with Shaull provided that Shaull would buy cattle and feed them on Shaull’s South

¹ Revised Article 9 addresses purchase money security interests in livestock in §9-324(d)
Dakota land. Feldman and Shaull agreed to share in profits and losses from the sale of calves. Feldman’s lender had a security interest in Feldman’s cattle, filed in Minnesota, but not South Dakota. Of course, Shaull defaulted on his loan to American Bank and American Bank claimed entitlement to all livestock on Shaull’s possession. Feldman and his lender claimed that Shaull was only a bailee. Shaull’s lender, American argued that Shaull had total control of the animals, and that Shaull and American could not have discovered Feldman’s or its lender’s interest in the cattle because neither had filed a prophylactic financing statement under §9-505, which permits an informational filing indicating the filer is a bailor and has an interest in goods held by the name Debtor.

The court held that Feldman and its lender were estopped from claiming the cattle in possession of Shaull. In the court’s view, possession by Shaull was the key factor in determining whether Shaull had sufficient rights in the collateral to grant a security interest. The holding implies that failure to file a prophylactic financing statement may be fatal to the asserted interest of the bailor or its lender. For another case discussing in detail whether a farmer raising livestock under an agreement with the purported owner in fact had an ownership interest in the livestock, see Matter of Porter, 202 B.R. 109 (N.D. Ind. 1996).

The ability of a partner to grant a security interest in hogs owned by the partnership as collateral for the personal debt of a partner was before the court in Lanesboro State Bank v. Fishbaugher, 383 N.W.2d 349 (Minn. App. 1986). In that case, Debtor borrowed money from Lanesboro State Bank (“Lanesboro Bank”) and gave as collateral livestock (hogs) owned by the “informal” partnership between Debtor and his father. The bank filed a UCC financing statement describing the collateral as an undivided one-half interest in livestock, which was a reference to the Debtor’s share of partnership money. The partnership then sold the livestock to a livestock broker and kept the proceeds without paying them to Lanesboro Bank. Lanesboro Bank sued the livestock broker for conversion. The broker defended, arguing that the Debtor had no legal right to encumber partnership property under the Minnesota Uniform Partnership Act. Therefore, said the broker, Lanesboro Bank did not have a perfected security interest in the hogs. The court found that the partnership law provision restricting the pledging of partnership property was for the protection of the partnership creditors, not the partner itself, and that the livestock broker could easily have checked the filing records before buying the hogs.

Cases Involving Growing Crops

In the crop financing cases, the relevant facts are necessarily different but bailment and ownership of the crops are the key issues.

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2 Although it is clear that any bailor should file a prophylactic financing statement as authorized under §9-505, the next question is where that financing statement should be filed. In Shaull, the bailor was in Minnesota, and the bailee in South Dakota, along with the cattle. §§9-301 and 9-305 therefore control the issue of where to file. See Meyer, “Current Article 9 Issues and Agricultural Credit”, *Drake Journal of Agricultural Law, Spring 2005*
In First National Bank v. Pleasant Hollow Farm, Inc., 532 N.W.2d 60 (SD 1995) the court faced a bailment or ownership issue with regard to sunflower seeds. In that case, the Debtor, Pleasant Hollow, borrowed money to plant and raise crops on 13,000 acres of sunflowers which it or one of its principals had leased. However, pursuant to a crop production contract, the crops being raised by Pleasant Hollow were actually owned by another entity, which we will call O. O had contracted to pay Pleasant Hollow to grow O’s crops. O’s officer met with the Bank and Pleasant Hollow prior to the time the Bank loaned Pleasant Hollow the money, and O did not state that O, and not Pleasant Hollow, owned the anticipated crop. O referred to Pleasant Hollow as “the people that farmed some property for him.” The South Dakota Supreme Court held that O was estopped to deny that Pleasant Hollow had sufficient rights in the collateral to grant a security interest in crops to Pleasant Hollow’s bank. The court said:

If the owner of collateral allows another to appear as the owner or to dispose of the collateral, such that a third party is led into dealing with the apparent owner as though he were the actual owner, then the owner will be estopped from asserting that the apparent owner did not have rights in the collateral.


In a case analogous to the cattle-sharing agreement cases, but instead involving crops, a Georgia court found that a landowner who was contractually only entitled to profits from a crop nevertheless had sufficient rights in the collateral to be able to grant an enforceable security interest in the crops to her lender. Southwest Georgia PCA v. James, 350 S.E. 2d 786 (Ga. App. 1986). There, Mrs. Whaley (“Landowner”) was financed by Bank. She subsequently entered into a joint venture agreement with Farmer, who was to raise peas on her land. Farmer was to provide seed, chemicals, labor, etc., and after all bills were paid, Farmer and Landowner were to split the profit. It turned out that the crop produced a loss, and not a profit. Landowner’s Bank sought to recover the crop proceeds, which amounted to $64,000. The court found in favor of Landowner’s bank, even though Landowner’s agreement with Farmer left no interest in the crop for Landowner. It appears that the court was concerned that Landowner was treating the bank unfairly by making an agreement that she was only entitled to crop profits, and not the crops themselves. This case resembles the cattle-sharing cases, where despite the parties’ agreement that they split only profits, the courts find that an interest in profits is in effect that same as an interest in the underlying property and generally finds for the party in possession.

Rights in the Seafood Cases

As long as this paper is organized, for better or for worse, under “types of collateral” let’s look at two cases involving rights in sea scallops. In Evergreen Marine Corp. v. Six Consignments of Frozen Scallops, 4 F.3d 90 (1st Cir. 1993) Evergreen Marine was an ocean carrier and it agreed to carry six loads of frozen scallops from Tokyo, Japan to New Jersey. Evergreen Marine issued bills of lading, and designated Gloucester Corp. as the “notify party.” Upon arrival in New Jersey, Gloucester took
delivery without presenting the bills of lading, and promptly thereafter became insolvent. The priority dispute was between Evergreen Marine’s lender, which held the bills of lading, and Gloucester’s lender. The lower court held that Gloucester had sufficient rights in the scallops to allow its lender’s security interest to attach, despite the fact that Gloucester could not and did not produce valid bills of lading, and that its rights were inferior to the rights of Evergreen or the Evergreen lender. The First Circuit reversed, holding in effect that Evergreen did not transfer any rights in the scallops when it foolishly gave up possession of the scallops to Gloucester, and that therefore Gloucester’s lenders did not have a security interest in the collateral.

It may be no coincidence that insolvent Gloucester Corp. is also the defendant in the second scallop case, Trust Co. Bank v. Gloucester Corp., 643 NE 2d 16 (Mass. 1994). In that case, the court held that the buyer of scallops, who took delivery under a sale agreement, obtained sufficient rights in the scallops for its lender's security interest to attach, even though the buyer's purchase of the scallops and obligation to pay was conditional on the obtaining of a Food and Drug Administration release. The court reasoned that the buyer, Gloucester, had more than mere "naked possession" of the scallops when it took delivery. Gloucester, in fact, had acquired a "special property and an insurable interest" pursuant to UCC §2-501 as soon as the scallops were identified to the contract of sale.

Government Payments

The issue presented is under what circumstances a Debtor/farmer acquires sufficient rights in government farm payments, such that his lender's security interest in that money or right to payment attaches. The issue is made more complicated by the difficulties inherent in understanding any given farm program benefit.

In an Arkansas bankruptcy case, the Debtor/farmer borrowed money for planting and cultivating his 2002 crop, and granted his lender a security interest in government payments. When the Debtor/farmer filed bankruptcy, the lender claimed rights to the 2003 government payments which were made after the bankruptcy case was filed. In re Stevens, 307 B.R. 124 (Bankr. E. D. Ark. 2004). The particular farm payments at issue were for the year 2003, but were authorized under the 2002 Farm Bill. In order to qualify, the Debtor/farmer had to sign up for the benefits during the period October 1, 2002 until June, 2003.

In that case, the issues included the question of when the Debtor/farmer became eligible to receive the particular payments—at time of application? At time of planting? At harvest? The court in Stevens found that the Debtor/farmer became eligible in 2002, before the filing of the bankruptcy case. Eligibility was found to be determined based on the date of application for the farm program, not on when the 2003 crop was planted. The court held that therefore the Debtor/farmer had "rights in the collateral" prior to his bankruptcy. Unfortunately for the lender, it had failed to properly perfect its security

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3 These cases are discussed in an article by Keith G. Meyer, "Current Article 9 Issues and Agricultural Credit", Drake Journal of Agricultural Law, Spring 2005 for pointing out and discussing this case.
interest in general intangibles (which the court found to be the proper category for rights to government payments) and therefore was unperfected.

The nature and extent of a farmer’s rights in loan deficiency payments (LDP's) was the subject of In re Otto Farms, Inc., 247 B.R. 757 (Bankr. C.D. Ill. 2000). The farmer granted to his lender a security interest in crops as well as general intangibles, "including government payments." According to the court, LDP’s are payments earned in time of depressed commodity prices. They are intended to make up the difference between current prices for commodities, and the Commodity Credit Corporation ("CCC") loan rates on those commodities. The LDP is issued based on an amount equal to the difference between the CCC loan rate and the posted county rate for the crop. They are paid to producers eligible for a commodity loan who agree to forego the loan in return for a payment. Payments are determined based on the number of bushels of actual harvested crop—not on estimated yields. Therefore, a crop must be harvested before a farmer is entitled to payments.

In Otto Farms, the Debtor/farmer, who filed bankruptcy before he harvested his crop, argued that the LDP payments were post-petition, unencumbered assets because he was not entitled to the payments until the crop was harvested, and because the lender's pre-petition security interest was cut off under 11 U.S.C. §552. The lender argued that prior to the filing of the case, the Debtor/farmer had sufficient rights in the collateral to allow its security interest to attach, and that it had not been cut off.

The court found that the LDP program was in place pre-petition and that the LDP payments were proceeds of pre-petition property rights, not subject to cutoff under the bankruptcy code. Therefore, the payments were to be turned over to the lender.

Conclusion

The wide variety of circumstances and bases for the courts's decisions in these cases suggest that it is difficult for parties to predict the outcome if a dispute over rights in the collateral arises. For the lender or practitioner seeking to avoid litigation, the lesson from these cases seems clear—the party seeking to become secured must ask questions and perform a diligent investigation of the borrower and its operations in order to ascertain:

-- where the collateral will be kept.

-- the exact nature of the arrangement under which the borrower claims an interest in the collateral.

-- whether a third party is involved in the keeping, raising or feeding of the collateral.

-- if the collateral is government payments, the nature of the program, when the benefits accrue, and whether they are dependent upon a crop or product coming into existence.
If the collateral is in the hands of a third party, or if third parties are involved in the transaction, the situation calls for greater scrutiny. At a minimum, a UCC search of the third party is needed. A visit to the facility and an interview with its manager is recommended. The lender should request or require a subordination agreement or other estoppel or consent letter from the third party, its lender, or both.
At the Spring Meeting in Tampa, our Subcommittee held a joint subcommittee meeting with the UCC Subcommittee on International Commercial Law. The meeting included a presentation, "Sovereign Bond Defaults and Aggressive Creditor Tactics", by Mark Cymrot of Baker & Hostetler and Michael Nelson of the Federal Reserve Bank of New York. Mr. Cymrot and Mr. Nelson discussed recent attempts to seize sovereign assets located inside and outside of the United States, particularly those involving defaulted Argentina sovereign debt. The presentation included a discussion of a Belgian law that was enacted recently in an effort to prevent holdout creditors from attaching Euroclear as a conduit for payments on restructured sovereign bonds. The presentation also included an analysis of the International Centre for Settlement of Investment Disputes as an alternate forum for sovereign creditors. The joint subcommittee meeting was well attended and everyone seemed pleased with the coverage of this timely topic.

Our Subcommittee will be participating in a program, titled "Is the World Really an Oyster: Current Issues in Trade Finance", at the ABA 2006 Annual Meeting on Friday, August 4, 2006, 11:00am -1:30pm, at the Marriott Waikiki Beach Resort, Oahu Room, 3rd Floor, in Honolulu, Hawaii. Our Subcommittee's participation in the program will be in lieu of a separate Subcommittee meeting at the event. The program will focus on the broad array of legal and practical challenges and opportunities presented in financing the importing and exporting of goods to and from the United States. The program is being presented jointly by the ABA Business Law Section Committee on Commercial Financial Services and Committee on International Business Law. The speakers for the program include Scott Siegel, Vice President and Regional Chief Counsel of CIT Trade Finance, Los Angeles, California, B. Otis Felder, Corporate Counsel of Princess Cruises, Santa Clarita, California, and James C. Chadwick, Partner, Patton Boggs LLP, Dallas, Texas.

Our next Subcommittee meeting will take place in conjunction with the ABA Business Law Section 2007 Spring Meeting. The meeting will focus on recent
legislative and case law developments relating to cross-border secured transactions. Additional particulars will follow in the next issue of the newsletter.

Members of the Commercial Financial Services and UCC Committees who have an interest in cross-border secured transactions and related areas are invited to join the Subcommittee by emailing the Chair at jchadwick@pattonboggs.com. **We look forward to seeing you in Honolulu!**
Conduit Loan Defeasance
With a background in structured finance, conduit lending and real estate, Commercial Defeasance, LLC was founded in 2000 to provide a single source solution for borrowers who want to defease a commercial loan. At Commercial Defeasance we handle every step of the defeasance process, including:

• Actively managing the process and parties to meet closing deadlines
• Optimizing and bidding out the securities portfolio
• Obtaining servicer, special servicer and rating agency consent
• Coordinating the “gap” style closing
WHAT IS DEFEASANCE?

The preferred form of call protection for fixed-rate CMBS loans.

• Defeasance is best thought of as a substitution of collateral in which qualified U.S. Government Securities replace the real estate.

• Redemption of principal and interest from the securities pays the scheduled monthly debt service and the balloon payment.

• Technically the Note remains in place but is repaid from proceeds of the securities purchased.
The Ground Rules

• First, the borrower’s loan documents must “allow for” the defeasance.

• Second, the borrower must pledge substitute collateral comprised of “government securities” as defined in the Investment Company Act (or the loan documents if narrower than the Investment Company Act).

• Third, the defeasance transaction cannot occur within the period ending two years after the REMIC’s startup day.

• Fourth, the defeasance transaction must be undertaken to facilitate a sale or refinance or some other customary commercial transaction and cannot be part of an arrangement designed to collateralize the REMIC with obligations that are not real estate mortgages.
WHY DEFEOASANCE?

- WHY BORROWERS CHOOSE DEFEOASANCE

- Most likely scenarios – Equity appreciation
  - Mezzanine Loans vs Defeasance
    - Permitted?
    - High borrowing costs / High transaction costs
  - Sale with assumption vs Defeasance
    - Permitted?
    - Assumption Fee
    - High Equity Component
WHY DEFEASANCE? (con’t)

2000 (purchase price)  
Loan $10.0 MM  
Equity 7.0 MM $3.0 MM

2006 (sales price)  
Loan $15.0 MM  
Equity 6.5 MM $8.5 MM

Most likely scenarios - Rising Interest Rates
## Hypothetical Mortgage Loan

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# Treasury Securities at 5%

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## Treasury Securities at 10%

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5-year Treasury Constant Maturity

Economic Chart Dispenser

http://www.Economagic.com
Inflation
Year-over-year change in the monthly level of the Consumer Price Index, seasonally adjusted.
# Loan Seasoning

<table>
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<th>Year</th>
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<tr>
<td>Maturity</td>
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Who is Involved?
WHAT IS INVOLVED IN A DEFEASANCE TRANSACTION?
Property is released and Government Securities become sole collateral for loan. Accountant’s report confirms sufficiency.
SB takes assignment of government securities and assumes note, pledge agreement and account agreement through assumption agreement.

SB owns securities and is responsible for accounting and tax returns, but SI holds them for the REMIC Trust’s benefit and uses the proceeds to make the loan payments directly to the servicer.
HOW DO WE STRUCTURE THE PORTFOLIO OF SECURITIES?
## AMORTIZATION SCHEDULE

<table>
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<th>Date</th>
<th>Coupon</th>
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<th>Principal</th>
<th>Total P&amp;I</th>
<th>Prin.Balance</th>
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<td>4,816,444.71</td>
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<td>(4,826,447.92)</td>
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WHAT COSTS ARE INVOLVED?

Defeasance costs fall into two categories:

- Cost to Purchase the Securities
- Transaction Costs
## COST ESTIMATE

### Current Defeasance Calculation
**US 5 Year Treasury 5.00%**

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<th>Transaction Cost</th>
<th>Estimated</th>
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<td>$27,810</td>
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<td>PRINCIPAL BAL. AT DEFEASANCE</td>
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<td>SECURITIES COST</td>
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<td>DEFEASANCE &quot;PREMIUM&quot;</td>
<td>$154,934</td>
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### Defeasance in 2 Years
**Assumed Forward Rate 7.00%**

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<td>MONTHLY DEBT SERVICE</td>
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<td>PRINCIPAL BAL. AT DEFEASANCE</td>
<td>$4,542,134</td>
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<td>$4,342,293</td>
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<td>DEFEASANCE &quot;PREMIUM&quot;</td>
<td>$199,841</td>
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**NOTE:** Required Fields:
- * Property Name: 123 Main Street
- * Purpose of Defeasance: Other
- * Servicer: Other
- * Original Loan Amt ($): 5,000,000
- * Loan Term (months): 120
- * Amortization (months): 360
- * Coupon/Interest Rate (%): 5.25
- * Interest Calculation: Act/360
- * Payment due on 1st day of month.
- * Note Dated: 2002
- * Est. Defeasance Date: 2008

I have read and understand the [Disclaimer](http://www.defeasewithease.com).
# Transaction Costs

Typical costs based on a $5,000,000 loan

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<tr>
<th>Transaction Cost:</th>
<th>Range</th>
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<tr>
<td>Rating Agency</td>
<td>0 - $15,000</td>
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<tr>
<td>Servicer Processing</td>
<td>$10,000 - $27,500</td>
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<tr>
<td>Special Servicer</td>
<td>0 - $5,000</td>
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<td>Custodian/Securities Intermediary</td>
<td>$6,000 - $10,000</td>
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<td>Servicer Legal</td>
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<td>Accountant</td>
<td>$4,000 - $10,000</td>
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<tr>
<td>Successor Borrower</td>
<td>$8,000 - $12,000</td>
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<tr>
<td>Commercial Defeasance</td>
<td>$15,000 - $25,000</td>
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<tr>
<td><strong>Total Costs</strong></td>
<td>$55,500 - $129,500</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>$55,000 - $75,000</td>
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<td>Legal Documents</td>
<td>Prepared By</td>
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<td>-------------------------------------------------</td>
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<tr>
<td><strong>Pledge Agreement</strong></td>
<td>Servicer’s Counsel</td>
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<td>- the pledge of securities to the Trust</td>
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<td><strong>Account Agreement</strong></td>
<td>Servicer’s Counsel</td>
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<tr>
<td>- describes how the securities will be handled</td>
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<tr>
<td><strong>Assignment, Assumption &amp; Release Agreement</strong></td>
<td>Servicer’s Counsel</td>
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<td>- describes the transfer of obligations from original borrower to successor borrower</td>
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<td><strong>Borrower’s Certificate</strong></td>
<td>Servicer’s Counsel</td>
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<tr>
<td>- confirmation from Borrower that all the conditions to defeasance have been met</td>
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<tr>
<td><strong>Waiver &amp; Consent Agreement</strong></td>
<td>Servicer’s Counsel</td>
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<tr>
<td>- waives certain of defeasance provisions that are not industry standard (i.e. defeasance on a non-payment date)</td>
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<td>Opinions</td>
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<td>New York Perfection &amp; Enforceability</td>
<td>Special NY Counsel (usually Servicer’s Counsel)</td>
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<td>REMIC</td>
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<tr>
<td>Organization/ Authorization/ Enforceability</td>
<td>Borrower’s Counsel</td>
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<tr>
<td>Organization/ Authorization/ Enforceability</td>
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<tr>
<td>Non-consolidation</td>
<td>Successor Borrower’s Counsel</td>
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</table>
How long does it take to defease a loan?

("My refinancing is closing in three days, is that going to be a problem?")

- A defeasance will typically take 30-45 days to close (initial notice to closing).
- Servicers and counsel experiencing high defeasance volume will enforce notice periods (usually 30 to 60 days).
- Still much shorter than assumption process and not much longer than time it takes to get a yield maintenance calculation.
- Defeasance transactions generally will run parallel to either the closing of a refinance loan, or in the case of a sale, the closing of the acquisition loan with the buyer’s new lender, because the proceeds of either a refinancing or sale are typically used to purchase the defeasance collateral.
Mechanics and Timing

• Borrower engages defeasance consultant in connection with transaction
• Borrower gives required notice to Lender/Servicer requesting defeasance
• Servicer/Servicer’s Counsel review defeasance provisions in loan documents
• Successor Borrower (if applicable) is identified by Lender or Borrower
• Accountant is engaged by Borrower to prepare verification report
• Servicer provides Borrower/Defeasance Consultant/Investment Bank with the loan amortization schedule and balance at maturity to determine payment requirements
Mechanics and Timing (con’t)

- Servicer’s Counsel prepares checklist and Defeasance Documents
  - Defeasance Pledge and Security Agreement
  - Defeasance Account Agreement
  - Defeasance Assignment, Assumption and Release Agreement
  - Certificate of Borrower
  - Defeasance Waiver and Consent Agreement

- Defeasance Consultant/Investment Bank performs “preliminary securities run” to identify securities to match payments required under the note

- Accountant prepares preliminary verification report based on Servicer payment schedule and preliminary securities run

- Borrower’s Counsel prepares release of mortgage and required opinion(s)

- If Rating Agency approval is required, Servicer’s Counsel or Servicer delivers review package to Rating Agencies with recommendation for confirmation
The “Three-Day” Closing Process

- Pre-Day One – Servicer’s Counsel distributes counterparts of the Defeasance Documents for execution by Borrower, Lender, Servicer, Securities Intermediary and Successor Borrower. Counterparts are returned to Servicer’s Counsel for delivery on Day One.

- Day One – The securities are purchased (“circled”) on credit for the Borrower. The lender’s counsel finalizes the closing instruction letter which includes all final defeasance costs, and delivers the closing instruction letter and executed mortgage release to the title company/escrow agent. The closing instruction letter contains disbursement and recording instructions for the title company/escrow agent to follow on Day Three.

- Day Two – The borrower’s refinance or sale transaction is closed and buyer or refinance lender funds proceeds to escrow agent. The title agent/escrow agent receives the closing instruction letter, the mortgage release and the sale or refinancing proceeds.

- Day Three – The defeasance consultant arranges for delivery of the securities to the securities intermediary. Upon confirmation from the securities intermediary of receipt of the securities, lender’s counsel authorizes an initial wire to the intermediary to pay for the securities. Upon confirmation by the intermediary of receipt of the wire for the securities and settlement of the trade, lender’s counsel authorizes the escrow agent to make all remaining disbursements and to record the mortgage release.
Key Issues for Borrowers Negotiating New Conduit Loans

- U.S. Obligations definition (Agencies vs. Treasuries)
- Lockout Period
- Mortgage Tax Savings
DEFEASANCE COST ESTIMATE

For a free defeasance cost estimate, e-mail or fax us the following:

* Promissory Note
* Loan Statement
* Target Closing Date

We will provide a cost estimate within 24 hours!
DEFEASANCE CONTACTS

Jeff Lee
704.248.2602
jlee@cdfllc.com

Bryan Bazemore
704.248.2604
bbazemore@cdfllc.com

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Josh Cohen
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Joseph Parry
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jparry@cdfllc.com

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Nora Warren
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nwarren@cdfllc.com

Adam Coleman
704.248.2600
acoledman@cdfllc.com
Securitization and Derivatives Subcommittee of the Commercial Financial Services Committee

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Blake, Cassels & Graydon LLP
Toronto, ON
Email: martin.fingerhut@blakes.com

Teresa Wilton Harmon, Vice-Chair
Sidley Austin LLP
Chicago, Illinois
Email: tharmon@sidley.com

Current projects of the Securitization and Derivatives Subcommittee of the Commercial Financial Services Committee include contributing to the drafting of securitization riders for the Model Deposit Account Control Agreement, updating our website and working with the Section of Business Law’s Pro Bono Committee to increase awareness of opportunities in microfinance.

Our subcommittee had an excellent meeting in Tampa in conjunction with the ABA Spring Meeting. Following our regular business meeting, Ed Smith of Bingham McCutchen and our Vice-Chair (soon to be our Chair), Teresa Harmon of Sidley Austin, updated us on recent changes to the model Deposit Account Control Agreement, and discussed plans to revise the Agreement to accommodate securitization transactions. Tony Nolan of Goodwin Procter then led a discussion on recent developments in legal opinion requirements under FAS 140 and on true sale opinion issues in various scenarios..

Our next meeting will take place in Hawaii at 10:00 am on Sunday, August 6th in conjunction with the ABA Annual Meeting in Hawaii, and will for the first time be held jointly with the securitization-related subcommittees of three other Committees. During this meeting we plan to discuss the status of the DACA form as well as other substantive topics of interest to subcommittee members.

Many thanks to Martin Fingerhut whose term as subcommittee chair is ending this summer. Please direct any questions or suggestions about the subcommittee to incoming chair Teresa Wilton Harmon, Sidley Austin LLP, (312) 853-7863 or tharmon@sidley.com. Also contact Teresa if you would like to become more involved in the subcommittee -- there are many volunteer opportunities, big and small.

We look forward to seeing you on the beach (after your active participation in our meeting!!).
## UNIFORM STATE LAWS SCORECARD

**Survey of Adoptions of Revised Official Text of the UCC**

As of June 2, 2006

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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 June 2, 2006.

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, (ii) the 1994 Official Text of Article 8 of the UCC, and (iii) the 1998 Official Text of Article 9 of the UCC.

2. All states have adopted the 1990 version of Article 2A with the exception of Louisiana and South Dakota. Louisiana has not enacted Article 2A and South Dakota still has the 1987 version of Article 2A. A 2003 version of Article 2A has been introduced in Kansas and Oklahoma, but has not yet been enacted in any state.

3. New York and South Carolina are the only states that still have the 1951 version of Articles 3 and 4.

UCC Item # 707

Last Revised: June 9, 2006