Dear Members:

In mid-April, Section members will gather in San Francisco for the Business Law Section’s Spring Meeting. The Spring Meeting will be held on Thursday, April 16th – Saturday, April 18th, at the San Francisco Marriott Marquis and the InterContinental San Francisco. Though the Marriott will be the “headquarters” hotel, in a departure from previous Spring Meetings virtually all of the meetings and programs for our committees will be held in the InterContinental. As such, you may wish to keep this in mind when making your hotel reservations.

We are pleased that our committees are again offering a robust number of meetings and programs. Together, CoMFin and UCC are the prime sponsors of six (6) CLE programs: (1) Current State of the Syndicated Loan Market (Thursday, April 16th, 10:30am - 12:30pm); (2) Worldwide Receivables Financing: How to Navigate the High Seas of Securing Accounts Arising from International Trade (Thursday, April 16th, 200 - 3:30pm); (3) Holder in Due Course No More? Highlights of the Pending Home Foreclosure Procedures Act (Friday, April 17th, 8:00 - 9:00am); (4) Patent, Trademarks and Copyrights: Dealing with IP Collateral When the Financing Falls Apart (Friday, April 17th, 10:30am - 12:30pm); (5) What Commercial Finance Lawyers Need to Know About Lending to Consumer Finance Companies (Saturday April 18th, 8:00 - 10:00am); and (6) Deals Aren’t Over at the Closing: The High-Stakes Game of Managing Ongoing Client Contracts and the Legal Errors That May Result (Saturday, April 18th, 10:30am - 12:30pm).

In addition, the Committees will hold the usual Joint Meeting on Thursday, April 16th, from 8-9:30am, and a joint committee dinner at Restaurant Lulu on Thursday evening, starting with an open bar at 7:30 pm. Restaurant LuLu is located at 816 Folsom Street, just a couple of blocks from the hotels and features a seasonal Provençal menu that showcases the products of its wood-fired oven, rotisserie and grill. The rustic, unpretentious fare is served family-style, encouraging a festive and communal atmosphere of good food in comfortable surroundings.

As always, our Committees and the vast majority of our subcommittees and task forces will be meeting. The entire schedule for the meeting is available on the Section’s website. If you are unable to attend the meeting in person, prior to the meeting we will provide dial-in information for the various committee, subcommittee and task force meetings.

You will note that one of our perennial programs, Commercial Law Developments, is not on the schedule for the Spring Meeting. This should not cause any anxiety or concern. This program will be offered at the Section’s Second Annual Meeting, to be held on Thursday, September 17 to Saturday, September 19, 2015, at the Hyatt Regency Chicago. We all look forward to this popular program at the Annual Meeting.

In this edition of the newsletter, we offer five diverse articles, including the following articles: (1) Scott Burnham - the revised Article 1 enactments, (2) Paul Hodnefield - UCC Article 9 Update: 2015 Legislation and Administrative Rules, (3) Whang-Ki Josh Jang, Shawn Bagdasarian and Steven Economou - The Perils of UCC-3 Terminations, (4) Norm Powell - Secured Lending to Series LLC’s and (5) Glen Strong - Absolute and Unconditional Guaranties under New York Law. Of course, we also extend a hearty thanks
September 17-19, 2015 - Business Law Section Annual Meeting - Hyatt Regency Chicago, Chicago, IL. Click here for more information.


April 7-9, 2016 – ABA Business Law Section Spring Meeting – Fairmont Queen Elizabeth and Hilton Bonaventure, Montreal, QC, Canada.

VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE FOLLOWING COMMITTEES AND TASK FORCES:

**COMFIN SUBCOMMITTEES AND TASK FORCES**
- Subcommittee on Agricultural and Agri-Business Financing
- Subcommittee on Aircraft Financing
- Subcommittee on Creditors' Rights
- Subcommittee on Cross-Border and Trade Financing
- Subcommittee on Past Chairs Advisory
- Subcommittee on Programs, Meetings and Communications
- Subcommittee on Real Estate Financing
- Subcommittee on Secured Lending
- Subcommittee on Syndications and Lender Relations
- ADR Task Force
- Model Intercreditor Agreement Task Force

**UCC SUBCOMMITTEES AND TASK FORCES**
- Subcommittee on Annual Survey
- Subcommittee on Article 7
- Subcommittee on Commercial Law Newsletter

We hope you enjoy this issue, and invite you to get involved in your committee(s). In addition, we look forward to seeing many of you in San Francisco.

Neal J. Kling
Commercial Finance Committee Chair
NKling@Shergarner.com

Norman M. Powell
UCC Committee Chair
NPowell@ycst.com

EDITORIAL BOARD

Sidney Simms
Editor (ComFin)
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Glen Strong
Editor (UCC)
Skadden, Arps, Slate, Meagher & Flom LLP
(312) 407-0608

We are pleased to announce that Christina Goebelsmann, an attorney with Wargo French, who has contributed to editing this edition, will be joining as an editor of the Commercial Law Newsletter at the upcoming Spring Meeting of the Business Law Section.

Featured Notes

Please join us at our Spring meeting in San Francisco. The Commercial Law Newsletter Editors will be holding a meeting on Friday, April 17, 2015, from 12:30 pm - 1:00 pm in the Nob Hill room on the Fourth Floor of the InterContinental San Francisco Hotel at the Spring Meeting. Current members of the Articles Advisory Board, as well as anyone interested in becoming involved with the Commercial Law Newsletter, whether suggesting topics, writing articles or assisting with publication, are invited to attend. If you cannot attend in person, please consider joining us by phone. The US dial-in number for our meeting is (866) 646-6488. The international dial-in number is (707) 287-9583. The conference code is 5716725219.

Also for those of you looking for good pro bono/volunteer opportunities, the ABA Business Law Section and Junior Achievement are partnering to promote youth financial literacy. Business lawyers often witness firsthand the high cost of ignorance about personal finances. Volunteer yourself and your firm to provide personal finance instruction to high school students within the Junior Achievement program. Check here for more information about the Section’s efforts.
Recent Developments

Revised Article 1 Enactments

By Scott J. Burnham

New York enacted revised Article 1, effective December 17, 2014, codifying it at N.Y. Uniform Commercial Code Law § 1-101 et seq. (McKinney 2014). New York enacted a number of variations from the uniform text. Like a number of other states, it retained in § 1-201(b)(20) the definition of good faith from former § 1-201(19) that limits good faith to “honesty in fact.”

New York also retained the former § 1-206 statute of frauds for contracts for the sale of certain personal property, codifying it as N.Y. Uniform Commercial Code Law § 1-207 (McKinney 2014). This provision has proven problematic in the past because it has been applied to non-Code transactions. See, e.g., Grappo v Alitalia Linee Aeree Italiane, 56 F.3d 427 (2d Cir. 1995) (sale of copyright). Presumably this practice will be discouraged by New York’s adoption of revised § 1-102, which makes clear that the provisions of Article 1 apply only to transactions governed by another article of the Code.

Finally, a 1990 amendment to former § 1-207 provides that a reservation of rights “does not apply to an accord and satisfaction.” That amendment was retained in uniform § 1-308(b), but New York did not enact the amendment in its version of § 1-308. This omission may be explained by the fact that New York has not enacted Revised Article 3, which provides a scheme for accord and satisfaction in § 3-311.

Unfortunately, New York did not enact amendments to all other statutes to conform them to the new Code citations. For example, as discussed in Recent Developments: Choice of Law Statutes that Dispense with a Reasonable Relation, Commercial Law Newsletter, July 1, 2014, New York General Obligations Law § 5-1401 refers to “a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code.” In revised Article 1, the choice of law rules are found in § 1-301, but the General Obligations Law was not amended to reflect that change.

South Carolina enacted revised Article 1, effective October 1, 2014, codifying it at S.C. Code Ann. § 36-1-101 et seq. (2014). The initial bill included the Official Comments in the text. The enacted version omits the Comments, but includes this non-conforming amendment to § 1-107:

The Official Comments, prepared by the Uniform Law Commission with the intent of aiding the user in understanding the provisions of each chapter, are to be included by the Code Commissioner in the annotated versions of this title, but are not considered part of the provisions of this title and do not indicate legislative intent.

Legislation to enact Revised Article 1 is pending in Georgia (see http://www.legis.ga.gov/Legislation/20152016/148668.pdf) and Wyoming (see http://legisweb.state.wy.us/2015/Introduced/HB0064.pdf). Enactment in those states would leave Missouri as the only one of the 50 states not to have enacted it.

The Recent Developments column is edited by:

Scott J. Burnham
Curley Professor of Commercial Law
Gonzaga University School of Law
sburnham@lawschool.gonzaga.edu

Shadi J. Enos
Buchalter Nemer
senos@buchalter.com
If so, submit an article for possible publication in a future issue of the Commercial Law Newsletter. Publishing an article with the Commercial Law Newsletter is a great way to get involved with the UCC Committee and the ComFin Committee. Articles can survey the law nationally or locally, discuss particular UCC or Commercial Finance issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the following Commercial Law Newsletter Editors: Sidney Simms, Harold J. Lee, Suhuyini Abudulai, Hilary Sledge-Sarnor, Glen Strong, or Celeste B. Pozo.

Summary of the Case

Before we proceed to the court’s analysis and holding, let us take a closer look at the events that led up to the Second Circuit’s rulings. In 2001, GM entered into a synthetic lease of $300 million (the “Synthetic Lease”), with respect to which JPMorgan was both a lender and administrative agent. Then, in 2006, GM entered into the Term Loan with JPMorgan, as both a lender and administrative agent. Both loans were secured and properly perfected by UCC-1 financing statements.

In 2008, GM informed its counsel, Mayer Brown LLP, that it intended to pay off the Synthetic Lease in full. Mayer Brown then prepared three UCC-3 termination statements to effect the termination of JPMorgan’s security interests with respect to the Synthetic Lease. Copies of these termination statements were distributed to GM, JPMorgan and JPMorgan’s counsel, Simpson Thacher & Bartlett LLP, for approval and authorization to file. Unfortunately, one of the three UCC-3s terminated the UCC-1 financing statement securing the Term Loan. This mistake became apparent after GM filed for bankruptcy in 2009, when the Committee of Unsecured Creditors filed suit against JPMorgan in order to ensure that the UCC-3 termination on the Term Loan was valid, cementing JPMorgan’s status as an unsecured party in the bankruptcy proceedings.

The steps taken by Mayer Brown, JPMorgan and Simpson Thacher to terminate the security interest in the Synthetic Lease were hardly unusual. GM notified Mayer Brown that it wanted to repay the Synthetic Lease, and that termination documents would be required. A partner at Mayer Brown assigned the matter to an associate, who in turn assigned the task of running lien searches against GM to a paralegal. The paralegal was unfamiliar with the matter and unaware that there was both a Synthetic Lease and Term Loan secured by these filings, and included in the list of security interests to be terminated the UCC-1 financing statement associated with the Term Loan. With this list, the associate then prepared a closing checklist and the necessary termination documents.

No one at Mayer Brown, Simpson Thacher, or JPMorgan noticed the inclusion of the Term Loan financing statement among the ones being terminated. In fact, the court even noted that after receiving drafts of the termination documents, an attorney at Simpson Thacher responded, “nice job […]”

In its inquiry, the court certified to the Delaware Supreme Court the question of whether it is “enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?” The Delaware Supreme Court explained that if the secured party authorizes the filing of the UCC-3, it is effective regardless of whether the secured party “subjectively intends or otherwise understands the effect of the plain terms of its own filing.” With that, the court made clear that neither subjective intent nor even a basic understanding of the UCC-3 are required, and that they will not factor into the analysis of the ultimate validity of a UCC-3 termination so long as proper authority has been granted by the secured party.

Relatedly, the court scrutinized whether JPMorgan had granted Mayer Brown the proper authority to file the UCC-3 termination that inadvertently included the erroneous UCC-1 financing statement. Relying on agency law, the court explained that “JPMorgan and Simpson Thacher’s repeated manifestations to Mayer Brown show that JPMorgan and its counsel knew that, upon the closing of the
Synthetic Lease transaction, Mayer Brown was going to file the termination statement that identified the Main Term Loan UCC-1 for termination and that JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed.”11 The Second Circuit ultimately held that “although the termination statement mistakenly identified for termination a security interest that the lender did not intend to terminate, the secured lender authorized the filing of the document, and the termination statement was effective to terminate the security interest.”12 JPMorgan lost its security for the Term Loan and became an unsecured creditor.

Potential Solutions

The outcome of this case could have been avoided simply with a stronger attention to detail in the process that was used to prepare and file these documents. The steps taken above by all parties appear to be normal practice. However, now that it is clear that the intention of a secured party does not matter once it authorizes the filing of an approved UCC-3 termination statement, it is even more important for law firms to come up with new strategies in order to avoid such situations and to protect themselves from potential malpractice claims. We have outlined below a few different processes that could be used to avoid such oversights in the future.

Financing Statement Formatting Strategy

Secured parties should utilize the optional reference portion on the bottom of UCC-1 financing statements. One option is for firms to indicate the client and matter reference number on every UCC-1 financing statement that it drafts and files, in order to have standard reference points that everyone in the firm can utilize to double check the specific transaction with respect to which the UCC-1 financing statement was created. Additional detail could be added to this portion of the UCC-1 in situations where there is a greater possibility for confusion; for example, the addition of either “Synthetic Lease” or “Term Loan” in the GM case. This would be an ideal way for others within the firm who happen upon a transaction they are not familiar with, to confirm that the security interests being terminated are associated with the correct transaction.

Law Firm Operations

In addition, the simple act of institutionalizing a thorough review process could avoid such mistakes. As attorneys, we are often subject to multiple pressing deadlines, and that can lead to a lack of ownership of documents and to reviews that are not as intensive as they could be. At times, we may even rush because we expect someone else involved in the transaction to take a more careful look at the documents before they are considered final. Using the example at hand, we can understand why someone with intimate knowledge of the deal needs to take responsibility for a final, thorough review. UCC-1 financing statements include a lot of important information that could be easily overlooked by someone unfamiliar with a matter. Only being able to understand where the secured party and debtor are listed is not enough; many times there are multiple filing dates associated with multiple transactions, and it is reasonable to see how mistakes like this get made. Establishing (i) an “owner of the document” and (ii) standard best practices for the review of particular documents can ensure that careless mistakes are avoided.

Conclusion

The GM case illustrates the dangers of a lack of oversight over what should be a fairly routine task. Rather than finding themselves secured, JPMorgan was left in the vulnerable position of an unsecured creditor for the sum of $1.5 billion in the midst of a bankruptcy proceeding. The takeaway is that while UCC-3 termination statements might be easy to file, the stakes can be high and the repercussions of mistakes catastrophic. Luckily, the risks can be mitigated by such quick fixes as utilizing the optional filer reference data section and putting procedures in place that establish legitimate review. With those simple steps, firms can avoid malpractice liability and ensure that their clients are properly protected, even in the worst of situations.

Whang-Ki Josh Jang, Shawn Bagdasarian and Steven E. Economou are associates of Buchalter Nemer.

Secured Lending to Series of LLCs:
Beware What You Do Not (and Cannot) Know - Part I

By Norman M. Powell

Editor’s Note: This article is the first of three installments focusing on “series LLCs”. This first part provides an introduction and overview of series LLCs—including what they are and are not, and what they can and cannot do. The second part (in the upcoming Summer edition of the Commercial Law Newsletter) will focus on the UCC consequences of series LLCs, while the third part (in the upcoming Fall 2015 edition of the Commercial Law Newsletter) will focus on the Bankruptcy Code implications for series LLCs.

Introduction

A “series LLC” is a limited liability company that has one or more “series.” In some ways a “series” is like a subsidiary of its
series LLC. But in other ways a series is unlike a subsidiary of its series LLC. Most series have their own assets and liabilities. Internal liability shields provide that assets associated with a given series are available only to creditors of that series, and not to creditors of other series or of the series LLC. Under the laws of most states that offer them, series can conduct their affairs in their own names. But many series might not be organizations or persons, and that has real consequences under the UCC and the Bankruptcy Code.13

What are Series?

Series Might Not Have Internal Shields. Most statutes don’t define the term “series” as such. Rather, they provide that an operating agreement may establish (or provide for the establishment of) one or more series of members, managers, assets, and economic rights. Note current laws do not require any publicly available notice of the mere existence of a series. But where additional preconditions (including public notice) are satisfied, the debts, obligations, and other liabilities of a given series are enforceable only against the assets of such series, not against the assets of any other series or the series LLC as a whole. This limitation is referred to as “internal shields.” Presumably, internal shields are important to most, if not all, lenders to series. Preconditions to existence of internal shields differ, but generally include publicly available notice of series existence. Some statutes require general notice filing with the Secretary of State (e.g., Delaware—notice can simply indicate that the series LLC has or may in the future have one or more series, and need not reference any specific series by name or otherwise14). Some require specific notice filing with the Secretary of State (e.g., Illinois—notice must be filed with respect to and specifically referencing each series by name15). In addition, the statutes generally require that the records maintained for any series account for the assets associated with such series separately from the other assets of the series LLC or its other series. Finally, inasmuch as the establishment of series is facilitated by the enabling statutes, but accomplished by or pursuant to provisions of the relevant limited liability company agreement, the LLC agreement must adequately provide for all relevant series. Thus, existence of internal shields requires satisfaction of both static requirements (e.g., the requisite filing and LLC agreement language), and ongoing requirements (e.g., maintaining the requisite separate records). Later failure to maintain the requisite separate records generally results in loss of internal shields. But the series continues to exist as a series despite the loss of internal shields.

Series Might Not Be Respected In Other States. With only a minority of states offering series, one may well wonder whether internal shields will be respected in states that don’t offer shielded series. Some say yes. They begin with a choice of law analysis under the law of the forum state, and look to the law of the state under which the series was formed. This approach implicitly assumes that shields are always and necessarily internal affairs under the internal-affairs conflict-of-laws doctrine.16 Others take a contrary view. A recent opinion offers compelling insights.

The dispute in Alphonse v. Arch Bay Holdings, LLC arose in the context of a residential mortgage foreclosure.17 The mortgage was held by and foreclosed by a series of a Delaware series LLC. Alphonse, the homeowner, did not defend, but later brought an action against the series LLC contending the foreclosure was based on robo-signing and therefore fraudulent. The trial court dismissed Alphonse’s suit, accepting the argument that the series and the series LLC were sufficiently separate from each other. The appeals court acknowledged that under Louisiana’s choice of law statute, the law of the state of formation normally determines issues relating to the internal affairs of an LLC. But the court went on to note that different conflict-of-laws principles apply where the rights of third parties (i.e., strangers to the LLC agreement, such as Alphonse) are involved.18 In its decision, the court quoted a district court decision interpreting California’s choice of law statute, to the effect that the internal affairs doctrine “does not apply to disputes that include people or entities that are not part of the LLC.”19

Series Might Not Be Entities. Though endowed with certain characteristics commonly found in separate legal entities, most series are statutorily prohibited from having other such characteristics. Given their many entity-like attributes, many assume series are separate entities. Some may even reason to that conclusion. But most statutes are silent (e.g., Delaware20). Some statutes state that an LLC’s governance documents may provide that its series are to be treated as separate entities (e.g., District of Columbia21), with the consequence that entity status is a matter of contract construction. Others provide separate entity status only where internal liability shields are in place and to the extent provided in their governance documents (e.g., Illinois22). Still others explicitly disclaim separate entity status (e.g., Texas23). Further complicating matters, a series may be an entity for some purposes, but not for others.24 For example, under the Treasury Department’s proposed regulations regarding the classification of series for federal tax purposes, a series is treated as an entity formed under state law, regardless of whether the series is a juridical person for state law purposes.25 Series cannot exist other than during the existence of the series LLC. They can be formed after or concurrent with the formation of the series LLC. Series can be terminated, or dissolved and wound up, without causing dissolution of the series LLC, but a series must be terminated or dissolved, and its affairs wound up, upon dissolution of the series LLC.

Series Can Have Unique Governance. Generally speaking, the statutes provide a default rule of series governance by associated members in proportion to their economic interests, though most open-endedly permit such other governance as may be agreed. Thus, a series can have most any governance structure. Governance of a series, for example, can differ from that of the series LLC, and governance of one series can differ from that of another series.

Series Can Have Unique Purposes. Most statutes generally provide that a series may have any lawful purpose. Some
authorize series both for profit and not for profit, and many exclude certain traditionally regulated activities such as banking. Some explicitly provide that a series’ purpose may differ from that of the series LLC, though it is generally less clear whether a series can have a purpose inconsistent with the purpose of the related series LLC. Statutes differ in explicitness with respect to such matters as holding title to real, personal, and intangible property, granting liens and security interests, and suing and being sued. Most statutes provide options for the holding of property. That is to say, while the statute tells us what’s possible, the filings and agreements tell us what’s in place. Alternatives generally include holding assets associated with a series (i) in the name of the series LLC, (ii) in the name of the series, and (iii) in the name of a nominee.

Key Differences Among Series Statutes. As noted above, a growing minority of jurisdictions offer series LLCs, including Alabama, Delaware, the District of Columbia, Illinois, Iowa, Kansas, Montana, Nevada, Oklahoma, Puerto Rico, Tennessee, Texas, and Utah. Texas is quite clear that a series is not an entity or organization. Alabama, Delaware, Montana, Nevada, Oklahoma, Puerto Rico, and Tennessee don’t explicitly address entity status. The District of Columbia, Illinois, Iowa, Kansas, and Utah provides that series with internal shields are to be “treated as” entities. No jurisdiction requires any public notice filing as a precondition to establishment of a series, though all require such notice as a precondition to internal shields. That said, only the District of Columbia, Illinois, Kansas, and Montana require notice identifying a specific series. In the other jurisdictions, a general notice to the effect that one or more series exist (or may exist in the future) suffices. In 2012, the Uniform Law Commission established a committee tasked with drafting a uniform or model act dealing with series of unincorporated business entities.

Conclusion

A series is something like, but not quite, a subsidiary. Where certain preconditions are satisfied, series may have internal shields. Those preconditions vary among the jurisdictions offering series, and don’t necessarily include any public notice of the existence, let alone the name, of any particular series. Universally, those preconditions include ongoing recordkeeping requirements. Thus, internal shields can be lost over time. Moreover, it’s unclear whether internal shields will be respected in many states that don’t offer shielded series. Choice of law rules do not mandate deference to the internal affairs doctrine when the aggrieved claimant was not a part of the related LLC. It is unclear, indeed doubtful, that many series are organizations or persons at all. Part Two considers the consequences of this last point in the context of secured transactions.

Norman M. Powell is a partner in the Delaware law firm of Young Conaway Stargatt & Taylor, LLP, where his practice includes formation of and service as Delaware counsel to corporations, limited liability companies, and statutory trusts, and the delivery of legal opinions relating to such entities, security interests, and other matters of Delaware law. He can be reached via email at npowell@yest.com. This article first appeared in 46 UCC L.J. 95 (2015), and appears here through rights retained by the author. Certain of this article’s topics are further explored in Mr. Powell’s articles Series LLCs, the UCC, and the Bankruptcy Code—A Series of Unfortunate Events, 41 UCC L.J. 103 (2008), and Opinion on Limited Liability Company Series, PRAC. LAW., Aug. 2014, at 19. Mr. Powell is grateful to his colleague John J. Paschetto for his editorial and analytical assistance.

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**Absolute And Unconditional Guaranties Under New York Law**

*By Glen F. Strong*

Under New York law, the general rule is that a guaranty is not enforceable if the underlying obligation which is guaranteed is not enforceable. However, many defenses of a guarantor can be waived. The New York Court of Appeals has held that, generally, absolute and unconditional guaranties foreclose guarantors from asserting any defenses or counterclaims. However, lower New York courts and federal courts interpreting New York law have determined that absolute and unconditional guaranties may not be enforceable under certain circumstances.

**General Rule**

The general rule under New York law, as stated by the New York Court of Appeals, is that a "guarantor is not liable unless the principal is bound."27 In Walcutt v. Clevite Corp., the creditor sued the guarantor on the guaranty. The guarantor asserted a defense of partial failure of consideration furnished by the creditor to the principal. The court stated:

There can be no doubt that a guarantor, when sued alone by the creditor, can successfully resist by showing that the creditor, on his part, totally failed to perform his obligations to the principal. In other words, the guarantor may always assert a total failure of consideration. This is because the guarantor is not liable unless the principal is bound (4 Williston, Contracts [rev. ed.], § 1215). By the same reasoning, the guarantor should be liable for no more than is his principal where there is a partial failure of consideration. By asserting such partial failure of consideration the guarantor does not avail himself of an
independent claim belonging to the principal nor does he arrogate to himself a right of election which his principal enjoys. Where the consideration fails, either partially or entirely, neither the principal nor the guarantor is accountable for anything which has not been received.\textsuperscript{28}

A recent example of this is the case of \textit{Kosich v. Catskill Millennium Technologies, Inc.}\textsuperscript{29} In \textit{Kosich}, the guarantors had executed guaranties of a promissory note; however, the promissory note had not been executed by the obligor and so was not enforceable against the obligor. The holder of the note sued the guarantors under the guaranty and obtained summary judgment against the guarantors. On appeal, the appellate court overturned the judgment against the guarantors because the holder of the note had not proved the validity of the guaranteed debt. This general rule has also been followed by the Second Circuit in interpreting New York law. In \textit{Pro-Specialties, Inc. v. Thomas Funding Corp.},\textsuperscript{30} the Second Circuit held that a guaranty is not enforceable against a guarantor unless the principal obligor is liable for the primary obligation.

**Unconditional and Absolute Guaranty Provisions Typically Enforced**

However, many defenses of a guarantor can be waived. Under New York law, unconditional and absolute guaranty provisions are typically enforced against a guarantor. In the seminal case of \textit{Citibank, N.A. v. Plapinger},\textsuperscript{31} the New York Court of Appeals enforced a guaranty of a term loan against a guarantor where the guaranty provided that the guaranty was an unconditional and absolute guaranty. In \textit{Plapinger}, corporate officers, including Plapinger, guaranteed a term loan from Citibank to the borrower, United Department Stores. When the corporation defaulted, Citibank attempted to collect the debt from the guarantors. In response, the guarantors alleged that they had been fraudulently induced to execute the guarantee as a result of Citibank’s agreement to fund an additional line of credit, which Citibank in fact never funded. The guaranty provided that it was "absolute and unconditional" and enforceable "irrespective of (i) any lack of validity * * * of the * * * Restated Loan Agreement * * * or any other agreement or instrument relating thereto, or (vii) any other circumstance which might otherwise constitute a defense' to the guarantee."\textsuperscript{32} The court held that the unconditional and absolute guaranty language precluded the guarantors from asserting that they were fraudulently induced to guarantee the loan. The court gave great weight to the fact that the absolute and unconditional guaranty provision was not "generalized boilerplate" but instead was the product of "extended negotiations between sophisticated business people."\textsuperscript{33}

Since \textit{Plapinger}, courts applying New York law have generally upheld unconditional and absolute guaranties. For example, in \textit{In re South Side House, LLC},\textsuperscript{34} the court stated that "Courts enforce absolute guarantees that include waivers of defenses and counterclaims. As one court has noted, '[a]bsolute and unconditional guaranties . . . are consistently upheld by New York courts' and 'unconditional guaranties have been held to foreclose, as a matter of law, guarantors from asserting any defenses or counterclaims.'"\textsuperscript{35}

**Absolute and Unconditional Guaranties Not Enforced in Certain Circumstances**

However, although this language and the language of \textit{Plapinger} is very broad, some courts have cut back on the enforcement of absolute and unconditional guaranties in certain circumstances, particularly in cases of fraud in the inducement, where there is a lack of specificity in the waiver language, or the illegality of the principal obligation. One such case is \textit{JPMorgan Chase Bank v. Liberty Mutual Insurance Co.},\textsuperscript{36} which involved surety bonds issued by insurance companies which guaranteed the obligations of Enron on several natural gas and crude oil forward contracts. The guarantors argued that they should not be required to pay under the guarantees since the forward contracts were really disguised loans which the guarantors were prohibited by law from guaranteeing. The guaranties contained the following waiver language:

"The obligations of each Surety hereunder are absolute and unconditional, irrespective of the value, validity or enforceability of the obligations of [Mahonía] under the [corresponding Contract] or Enron under [its separate guarantees] or any other agreement or instrument referred to therein and, to the fullest extent permitted by applicable law, irrespective of any other circumstance whatsoever that might otherwise constitute a legal or equitable discharge or defense of a surety in its capacity as such."\textsuperscript{37}

The plaintiff argued that, based on \textit{Plapinger}, this language prevented the guarantors from raising the fraudulent inducement defense. The court, however, did not agree with this interpretation of \textit{Plapinger}. "But neither \textit{Plapinger} nor its progeny avails plaintiff here, for several reasons. To begin with, a full and fair reading of \textit{Plapinger} makes plain that it does not stand for the extraordinary proposition — the logical extension of plaintiffs interpretation — that a general sweeping disclaimer can serve to disclaim any and all extrinsic fraud between sophisticated parties."\textsuperscript{38} The court also stated that nothing in the doctrine of \textit{Plapinger} precludes a defense of fraudulent inducement or concealment premised on fraudulent misrepresentations in the Bonds themselves. Here each of the Bonds is expressly premised on Mahonia’s having entered with Enron into a gas or oil "Inventory Forward Sale Contract" and expressly recites that once all the contracted-for gas or oil "is fully delivered" the Sureties’ obligations will cease. Plainly implicit in these representations is the assertion that the Sureties are being asked to insure the sale and future delivery of a commodity, rather than being asked to insure, unlawfully, a disguised loan transaction.\textsuperscript{39}
Another case finding an exception to the general rule set forth in Plapinger is Manufacturers Hanover Trust Co. v. Yanakas, where the Second Circuit held that general waiver and absolute and unconditional language in the guaranty was not sufficient to preclude the guarantor from asserting a fraudulent inducement defense to the guaranty. The court placed great weight on the fact that the waivers were not negotiated but rather included on a preprinted form.

Yet another example is Morgan Guaranty Trust Co. of New York v. Chodorow, where the court determined that, notwithstanding the fact that the guaranty provided that it was absolute and unconditional, the Plapinger rule did not preclude the guarantor from raising a defense of fraudulent inducement based on a claim that the conditions precedent to the guaranty had not been satisfied.

Another exception to the enforceability of an absolute and unconditional guaranty is the illegality of the underlying principal obligation. If the underlying guaranteed obligation of the principal violates a statutory protection where the public interest is involved or where the statute provides that the violation of such statute would cause the agreement to be void, courts interpreting New York law have held that the guaranty may not be enforced against the guarantor, even if the guaranty contains absolute and unconditional language. In Elliott Associates, L.P. v. Republic of Peru, the guarantor asserted that the purchase of the underlying guaranteed obligation violated New York law and so the guarantor was not required to pay under the guaranty. The creditor argued that the guarantor had waived this defense in the guaranty. The guaranty contained language providing that the guarantor "shall pay all such amounts regardless of any law, regulation or order now or hereafter in effect in any jurisdiction" and "the Guaranty shall be 'absolute and unconditional irrespective of... any other circumstance which might otherwise constitute a defense available to... any Obligor.'" The court held that the statute was a penal statute which affected the public interest and so any purported waiver of such statute was ineffective.

Similarly, in Stonehill v. Security National Bank, the guarantor asserted that the underlying guaranteed obligation violated Regulation U and so the guarantor was not required to pay under the guaranty. The creditor argued that the guarantor had waived such defense. The guaranty provided that "[t]his guarantee shall be construed as a continuing, absolute and unconditional guarantee of payment, without regard to the validity, regularity or enforceability of any of said Obligations or purported Obligations." The court acknowledged that "[u]nder New York law, a guarantee containing such a clause will be construed to be broader than the principal obligation, and in some circumstances the guarantee may be enforced even though the principal obligor has a defense in respect of his narrower obligation." However, in the case of a loan which violated securities laws, the court stated that "I have found that to allow a bank to recover on a guarantee even though the underlying loan violated Regulation U would encourage banks to extend credit in violation of the margin requirements. I therefore hold that insofar as a guarantee provision purports to allow a bank to recover on a guarantee even though the underlying loan violates Regulation U, it is void as a violation of § 29(a) of the Exchange Act." New York courts have also set forth a standard which requires that in enforcing a guaranty the creditor must prove the underlying debt, even if the guaranty is absolute and unconditional. In City of New York v. Clarose Cinema Corp., the court stated that "[i]n a motion for summary judgment to enforce a written guaranty, all that a creditor need prove is an absolute and unconditional guaranty, the underlying debt, and the guarantor's failure to perform under the guaranty." The implication, then, is that if the creditor cannot prove the underlying debt then the guaranty would not be enforceable against the guarantor, even though it is absolute and unconditional. The application of this rule is evidenced by Sunbelt Rentals, Inc. v. New York Renaissance. In Sunbelt Rentals, an equipment lessor sought to recover unpaid equipment rentals from the guarantors. The guaranties guaranteed the obligations which New York Renaissance owed to the lessor. The guaranties were absolute and unconditional. The guarantors claimed that they were not liable under the guaranties because, while they had guaranteed the obligations owing from New York Renaissance to lessor, the equipment was actually rented by a different legal entity, American Renaissance. The court, quoting Clarose Cinema, stated that, on a motion for summary judgment to enforce a written guaranty, "the creditor needs to prove an absolute and unconditional guaranty, the underlying debt, and the guarantor's failure to perform under the guaranty." The court then determined that, although the guarantors had executed the guaranties and the guaranties were absolute and unconditional, the lessor had not established the underlying debt and so the motion for summary judgment was denied.

Conclusion

In summary, the New York Court of Appeals has held that, generally, absolute and unconditional guaranties foreclose guarantors from asserting any defenses or counterclaims. However, lower New York courts and federal courts interpreting New York law have determined that absolute and unconditional guaranties may not be enforceable under certain circumstances, particularly in cases of fraud in the inducement, where there is a lack of specificity in the waiver language, or the illegality of the principal obligation.

Glen F. Strong is an associate at Skadden, Arps, Slate, Meagher & Flom LLP.
UCC Article 9 Update: 2015 Legislation and Administrative Rules

By Paul Hodnefield

Every year, state legislatures and filing offices take actions that can impact the UCC filing and search process. This article surveys those initiatives currently pending for 2015, including Article 9 legislation, fraudulent filing prevention measures, and filing office updates to the UCC administrative rules.

Article 9 Legislation

The widespread enactment of the 2010 Amendments to UCC Article 9 (the “Amendments”) has substantially reduced the number of legislative measures introduced by the states this year that could affect the UCC filing or search process. As of March 1, 2015, just a handful of bills were currently pending.

Only two states, Oklahoma and the US Virgin Islands (“USVI”), have yet to enact the Amendments. Aside from the Pacific territories and Indian tribes, which are not expected to adopt Revised Article 9 with the Amendments in the foreseeable future, all other U.S. jurisdictions currently have the Amendments in effect.

Oklahoma was one of the very first states to introduce legislation to enact the Amendments legislation back in 2011. Since then, at least 4 separate bills to enact the Amendments were introduced but failed to make it through the legislature. Three new bills to enact the Amendments were introduced in 2015, two in the Senate and one in the House.

The pending Oklahoma bills generally follow the official text and are all mostly similar, but they do have a few significant differences. All three of the bills adopt the Legislative Alternative A “Only If” rule for sufficiency of individual debtor names in § 9-503(a)(4) and set forth the text of the new forms in § 9-521. However, the effective dates are not consistent. Two bills, HB 1773 and SB 421, provide an effective date of November 1, 2015. The remaining bill, SB 175, provides an effective date of July 1, 2016.

Senate Bill 421 includes a provision that could, if enacted, affect a substantial number of filed records. The bill would amend Oklahoma’s version of § 9-501(a)(2) to move the central filing office from the Oklahoma County Clerk to the Secretary of State.

Changing the central filing office ordinarily would not create a serious issue. Many jurisdictions successfully changed the designated filing office within the state when Revised Article 9 took effect in 2001. Revised Article 9, however, included a transition rule for this purpose. A secured party could use a financing statement in lieu of continuation (“In Lieu”) under § 9-706(a)(2) to remain perfected when Revised Article 9 changed the filing office within the state.

The corresponding transition rule in § 9-806(a)(2) did not contemplate that the Amendments would change the filing office within a state. The new transition rule only makes an In Lieu effective to continue the effectiveness of a record filed in another state. Records filed with the Oklahoma County Clerk would remain effective until the next lapse date, but secured parties could not use an In Lieu to re-file the record with the Secretary of State and still retain the original priority. If the bill moves forward, the legislature should correct this drafting oversight.

The prospects for all of the Oklahoma Amendments bills in 2015 remain uncertain. Similar bills have struggled to make it out of committee over the past few years. However, it will be important to keep a close eye on SB 421. Secured parties and their legal counsel will need time to prepare for the change of filing office if that provision makes it through the legislative process.

As of March 1, 2015, the USVI awaits introduction of a bill to enact the Amendments. A draft request was submitted in September 2014. The resulting bill is expected to be introduced sometime during the 2015 legislative session.

A bill related to the Amendments is currently pending in Oregon. Oregon was one of the few states that originally enacted the Amendments with the Legislative Alternative B safe harbor for individual debtor name sufficiency under § 9-503(a)(4). Senate Bill 462, introduced earlier this year, would replace Alternative B with the Alternative A “Only If” driver’s license rule. A similar measure failed to make it out of committee last year. This year, the bill is still pending in committee.

It appears that only one state has introduced Article 9 legislation unrelated to either the Amendments or fraudulent filing concerns. Four bills are currently pending in the Tennessee legislature to extend the perfection period for a purchase-money security interest (“PMSI”). Tennessee’s already non-uniform version of § 9-324(a) provides that a PMSI must be perfected by filing before or within 30 days after the debtor receives possession of the collateral. All four of the pending bills would amend § 9-324(a) to change the perfection period to 60 days.

Fraudulent UCC Filing Legislation

Each year, a number of bills are introduced around the country to address the filing of fraudulent UCC records. This year is no
exception. Several states currently have legislation pending to address this problem.

One state, Utah, introduced a bill that substantially adopts the “Hip-Pocket” Amendment that the Bogus Filing Working Group recommended to the Uniform Law Commission for use by states that prefer a more uniform approach to the issue. The Utah bill, SB 93, makes some departures from the original draft to give the filing office more flexibility in administering the law. The bill is progressing through the Utah legislature and has a good chance of passing this session.

Two bills are pending in Maryland, HB 312 and SB 77, that would give the filing office authority to investigate allegedly fraudulent UCC records upon the filing of an affidavit by the debtor. The bills also give the filing office authority to terminate records that it determines are fraudulent.

A carry-over bill pending in the New Jersey Senate has raised some concern for commercial lenders. The bill, AB 2481, was introduced early last year, passed by the Assembly in December and is currently pending in the Senate. Among other provisions, the bill would require as a condition of sufficiency under the state’s version of § 9-502(a)(2) that a financing statement provide the legal name of the secured party. While this measure is intended to prevent the filing of fraudulent records, it actually creates potential traps for the unwary secured party.

Many commonly-used forms of secured party names, including trade names and those that include the secured party’s capacity, might render a financing statement insufficient if the current version of AB 2481 were enacted. There is no equivalent to § 9-506(c) that would prevent a variation of the secured party’s name from rendering the financing statement seriously misleading. Moreover, the current bill text omits any transition rules or limitations on its application. The bill simply states that it takes effect immediately.

Various stakeholders have proposed amendments to AB 2481 that would limit the bill’s impact on records submitted by legitimate UCC filers. Consequently, the current text of the bill may change in the coming months.

Several other states, including Indiana, Kansas, Nevada, New York and Pennsylvania, have introduced legislation this year to amend existing fraudulent UCC filing laws. These bills typically include enhanced penalties, additional remedies and clarified procedures for dealing with fraudulent UCC records.

Filing Office UCC Administrative Rules & System Status

The filing office administrative rules for the UCC play an important part in the UCC process. The rules not only set forth the procedures that the filing office must follow to implement Article 9, they also provide guidance to those who search and file UCC records.

Most state-level filing offices have adopted a version of the Model Administrative Rules (“MARS”) promulgated by the International Association of Commercial Administrators (“IACA”). IACA made some MARS updates in 2012 to ensure that the procedures and terminology were consistent with the Amendments.

By May, 2014, almost a year after the Amendments took effect in most states, only 10 state-level filing offices had updated their UCC administrative rules. This year, that number has risen to 19. Nevertheless, most state-level UCC filing offices are still operating under the UCC rules adopted for Revised Article 9, not the updated version designed to implement the Amendments.

As of March 1, 2015, 25 of the 51 states that have enacted the Amendments, including D.C. and Puerto Rico, still have not updated the UCC administrative rules. An additional 7 states have never adopted or published any UCC administrative rules.

Despite the outdated published rules, nearly all of the state-level filing offices, as well as local offices operating under central authority in Georgia and Louisiana, are following practices consistent with the Amendments. The problem for filing office stakeholders is that the published rules may not reflect actual filing office practices and terminology. Consequently, those who file or search the UCC records should be careful about relying on any UCC administrative rules adopted prior to 2014.

IACA currently has a working group conducting the most detailed review and update of MARS in almost ten years. The working group will present the updated MARS to the IACA membership for approval at the Annual Conference in May 2015. The expectation is that more states will move forward to revise outdated rules once the new MARS receive approval.

A somewhat related issue is that some filing offices have not yet updated their online UCC filing systems since the Amendments took effect. Often, the filing office had a new system in development that would include updates for the Amendments. Thus, it did not make sense to update an old system that would be replaced almost immediately. Unfortunately, system development often takes longer than original estimates. As a result, a few state-level filing offices are still using the older systems until they can implement the new systems.
Nevertheless, the older systems work just fine for the vast majority of electronically-filed UCC records. The only problems arise when the collateral is held in a trust or is being administered by a decedent’s personal representative. The provisions in the old systems which contained indications that the debtor was a trust, trustee acting with respect to property held in a trust or a decedent’s estate may no longer be sufficient for records filed after the Amendments took effect.

If the collateral is held in a trust or is being administered by a decedent’s personal representative and the state’s electronic filing system has not been updated for the Amendments, the filer should consider submitting the financing statement as a written record. In the alternative, the filer can provide the text of the new indications in the collateral field of an electronically-filed record.

Summary

With only a couple of exceptions, the Article 9 legislation pending in 2015 should not cause any substantial changes to the UCC filing or search processes in most states. Even the pending provisions of most concern, the Amendments in Oklahoma and fraudulent filing bill in New Jersey, may not survive the legislative process in their current form.

Despite the outdated UCC administrative rules that most jurisdictions still have in place, the filing offices are generally operating in compliance with current law. The UCC administrative rules and computer systems will eventually catch up with current law and practices. Until then, filing office stakeholders should not rely on the administrative rules without first verifying that they have been updated to reflect current law.

Paul Hodnefield is Associate General Counsel for Corporation Service Company. Please feel free to contact him with questions or comments at paul.hodnefield@csglobal.com or 800-927-9801, ext. 61730.

UCC Spotlight

The UCC Spotlight will return in the Summer, 2015 Issue!

Useful Links and Websites


Please find below a list of electronic links that our members may find useful:

1. www.lexology.com – In cooperation with the Association of Corporate Counsel, Lexology provides articles and practical tips relating to the practice of law.
2. The UCCLAW-L listserv is sponsored by West Group, publisher of the “UCC Reporting Service.” The listserv is an e-mail discussion group focusing on the Uniform Commercial Code. To subscribe to the UCCLAW-L listserv, go to http://lists.washlaw.edu/mailman/listinfo/ucclaw-l
5. Gonzaga University’s new Commercial Law Center has a variety of links to useful sites and can be accessed at http://www.law.gonzaga.edu/Centers-Programs/commercial_law_center/default.asp
6. The International Association of Commercial Administrators (IACA) maintains links to state model administrative rules (MARS) and contact information for state level UCC administrators. This information can be accessed at http://www.iaca.org
7. The Uniform Law Commissioners maintains information regarding legislative reports and information regarding upcoming meetings, including the Joint Review Committee for Uniform Commercial Code Article 9. You can access this information


10. The Secretariat of Legal Affairs (SLA) develops, promotes, and implements the Inter-American Program for the Development of International Law. For more information, go to http://www.oas.org/DIL/

11. The National Law Center for Inter-American Free Trade (NLCIFT) is dedicated to developing the legal infrastructure to build trade capacity and promote economic development in the Americas. For more information, go to http://www.natlaw.com


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Endnotes

2 Id. at *3.
3 Id. at *4.
4 Id. at *5.
5 Id. at *6-7.
6 Id. at *4-6.
7 Id. at *13.
8 In re Motors Liquidation Co., 755 F.3d 78, 86 (2d Cir. 2014).
10 JPMorgan I, 2015 WL 252318, at *8.
11 Id. at *14.
12 Id. at *2.
15 805 ILL. COMP. STAT. ANN. 180/37-40(b), (c) (LexisNexis).
17 Abbotson v. Arch Bay Holdings, LLC, 548 F. App’x 979 (9th Cir. 2013).
18 Id. at 986 (citing First Nat’l City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 621 (1983)).
19 Id. (quoting Butler v. Adoption Media, LLC, No. C04-0135 PJH, 2005 WL 2077484, at *1 (N.D. Cal. Aug. 26, 2005)).
21 D.C. CODE § 29-802.06(b) (LexisNexis).
22 805 ILL. COMP. STAT. ANN. 180/37-40(b) (LexisNexis).
23 TEX. BUS. ORGS. CODE ANN. § 101.622 (West 2013).
24 “Sometimes words have two meanings.” ROBERT PLANT, Stairway to Heaven, on an untitled album (Atlantic Records 1971).
26 The Series of Unincorporated Business Entities Committee is chaired by Steven G. Frost, Partner, Chapman and Cutler, LLP, Chicago, Illinois; its reporter is Daniel S. Kleinberger, Professor, William Mitchell College of Law, St. Paul, Minnesota. The author participates in the SUBE Committee as an American Bar Association Business Law Section Advisor.
28 Id. (alteration in original).
29 97 A.D.3d 1003 (3d Dept 2012).
30 812 F.2d 797 (2d Cir. 1987).
32 Id. at 95 (alterations in original).
33 Id.
35 Id. at 675 (alterations in original) (quoting First N.Y. Bank for Bus. v. DeMarco, 130 B.R. 650, 654 (S.D.N.Y. 1991)).
37 Id. at 27 (alterations in original) (citation omitted).
38 Id. (citation omitted).
39 Id. at 27-28 (citation omitted).
40 7 F.3d 310 (2d Cir. 1993).
43 Id. at 357 (alterations in original) (citation omitted).
45 Id. at 34.
46 Id.
47 Id.
48 256 A.D.2d 69 (1st Dep't 1998).
49 Id. at 71.
51 Id. at *10-11.