Letter from the Chair

Sherwin P. Simmons, II
Akerman Senterfit
Tampa, FL

As Chairman of the Business Law Section's Young Lawyer Committee, I would like to invite you to join us in Boston, Massachusetts for the Eighth Annual Institute for the Young Business Lawyer, scheduled for April 14, 2011, during the Section's Spring Meeting.

In the past, the Institute focused on core topics and "nuts and bolts" programming and this has been very successful; however, we expanded the scope last year in Denver to not only include the "nuts and bolts" programming directed towards the New Business Lawyer but also programming for the more advanced Young Business Lawyer. Programming this year will be broken down into concurrent sessions with one room designated for the "nuts and bolts" programming and the other room designated for the more advanced programming followed by a plenary session focusing on the legal side of the Facebook and the rise of social media.

The day will start off with a networking breakfast where you can meet and mingle with your fellow Institute participants. There will be a lunch in the middle of the day and a brief overview meeting of the Young Lawyer Committee followed by the plenary session. There will also be Section Orientation, followed by the Section Welcome Reception, followed by the always fun Young Lawyer Committee Annual Dinner. This year, the dinner will be at the Mantra Restaurant! All of these opportunities are offered for the low cost of $199.00 plus the cost of the dinner ticket. The program brochure and registration information can be found here.

Due to the economy and the pressures facing Young Lawyers, an opportunity to obtain legal education in the fields you directly work in and to have social and marketing opportunities make the Institute and Young Lawyer Committee an easy choice. The Young Lawyer Committee provides opportunities to members of the Business Law Section under 40 or whom are in practice for less than ten years to become involved in the Section and provide a common meeting ground. The Committee provides its members with numerous education, training, leadership, business development and social events and opportunities. Our main focus is to integrate members into the framework of the Business Law Section and create future leaders of the Section.

The Young Lawyer Committee has provided wonderful opportunities to me and I would like to extend an invitation to you personally to allow us to provide you with these wonderful opportunities. I look forward to seeing all of you on April 14th in Boston at the Institute.

I am happy to discuss the Institute, the Young Lawyer Committee, the Section and leadership opportunities with you. Feel free to email me at sherwin.simmons@akerman.com or call me at 813.209.5039.

--Sherwin P. Simmons, II
Chair, Young Lawyer Committee

Message from the YLF Committee

On behalf of the Business Law Section's Young Lawyer Committee, we invite you to join us for the Eighth Annual Young Business Lawyer Institute, scheduled...
for Thursday, April 14, 2011, in Boston, Massachusetts, during the Section's Spring Meeting.

The Institute will feature an activity-filled day of timely and important continuing education programming targeted at business lawyers in the early years of their career (but don't worry, there is a mix of content that even business lawyers with numerous years in practice will find extremely valuable).

There will also be a networking lunch, a welcome reception, a leadership opportunity meeting, and a high-energy evening event. All of these opportunities are offered to you in a one-day package. The YLC Social Committee is busy planning our always-popular post-Institute dinner at Mantra Restaurant in Boston. In order to attend, first register for the Institute and then download and return this dinner registration form. The dinner sells out quickly so sign up now!

The YLC: A Wise Choice and Wonderful Opportunity

With more demands upon us than time, one-stop opportunities such as those offered by Young Lawyer Committee are a wise choice. The Young Lawyer Committee serves as a center of gravity for business lawyers under the age of 40. Every Business Law Section lawyer member who meets these criteria is automatically a member of the Young Lawyer Committee. The Committee provides its members with numerous opportunities for education, training, networking, socializing, leadership and business development. The Committee also strives hard to integrate its members into the Section's substantive committees and to assist them in finding a home in active Section work.

Make friends, generate business, network with lawyers from around the world, join a committee and learn something new. Your firm might even sponsor you.

We encourage your participation and activism, and look forward to seeing you in April 2011!

ABA Section of Business Law Spring Meeting

About the Institute for the Young Business Lawyer:

On behalf of the Young Lawyer Committee of the ABA Business Law Section, I'd like to take this opportunity to encourage you to join us for the 8th Annual Institute for the Young Business Lawyer. In addition to providing top-notch CLE programs, the Institute is a fantastic opportunity for young lawyers to get involved with the YLC and learn more about the benefits of membership in the Business Law Section. This year's programming includes:

- **Networking Breakfast**

- **Plenary Session:** Insights from Legal Luminaries  
  A Q&A session with esteemed members of The Business Law Advisors

- ** Concurrent Sessions 1**  
  - How To Use Forms Wisely In Secured Transactions  
  - Basics Of Consumer Credit Regulation: A Context For Federal Financial Services Reform

- **Concurrent Sessions 2**  
  - How To Handle A Government Subpoena  
  - LLC's And The Rest Of The Legal World

- **Networking Luncheon**

- **Concurrent Sessions 3**
Additional YLD Sponsored Program at Spring Meeting:

Fad or Future? Social Media’s Role in Today’s Legal Profession.

Unless your face has been buried in a book for the past five years, you may have noticed that the legal profession is very much atwitter these days concerning lawyers linking in to social media. Bad puns intended.

As a young business lawyer, you may have been among the first wave of legal professionals to settle this new digital frontier by creating profiles on any number of social networking sites like LinkedIn, Twitter, Facebook, Avvo, or MySpace. But now what? How do you strike the right balance between personal and professional usage of social media? On the professional side, how do you justify the time, energy, and effort needed to leverage your participation in social media as a strategic conduit for both career and client development? How do you accomplish either objective without running afoul of the ethics rules? How do you explain your enthusiasm for social media and the value of this technology to the naysayers and legal Luddites who dismiss it all as a passing fad or an unwanted distraction from the almighty billable hour? And will any of this be worth the effort in the long-run?

Join the Young Lawyer Committee on Saturday, April 15, 2011, from 10:30am - 12:30pm during the Section's Spring Meeting in Boston for a special CLE program regarding the role of social media in today's legal profession. This must-see program is designed for business lawyers (at any experience level) who are interested in pursuing successful social media strategies to develop new business and enhance their professional competency. Panelists will discuss the emerging ethical implications for lawyers using of social media, including the various pitfalls that all lawyers should be careful to avoid.

We hope you will join us for this exciting and informative new program.

Pro Bono and Public Service Opportunity:

The Young Law Committee and the Pro Bono and Public Service Subcommittee of the Business and Corporate Litigation Committee are partnering with Junior Achievement during the Business Law Section’s Spring Meeting in Boston for its pro bono public service project.

On Wednesday, April 13 from 3:30 p.m. To 5:30 p.m. Volunteers from the Business Law Section will meet with Junior Achievement students from local high schools to present on the topic of business ethics.

If you would like to volunteer as a guest speaker for this project, please contact Kristin Gore at kgore@carltonfields.com or Victoria Mitchell at victoria.mitchell@hklaw.com for more information.
Featured Articles

**Thirteen Practical Tips for "Closing"**
*Cara Bradley*

"Closing" a transaction is one of the most important duties performed by a junior business attorney. A transaction is considered closed when all requisite documents have been negotiated, signed and delivered, any instruments or certificates have been exchanged, authorizations and consents are final and effective, and any funds have exchanged hands. The following checklist contains practical tips to help ensure your next closing will proceed in a smooth and orderly fashion.

[More...](#)

**Custody Rules for Investment Advisors**
*Amy Rigdon*

On December 30, 2009, the Securities and Exchange Commission (the "SEC") published its final rule amending the Custody Rule and related forms and rules. These amendments became effective March 12, 2010, and affect four main areas: (1) account statements; (2) additional surprise examinations; (3) physical custody of client assets; and (4) enhanced compliance and reporting obligations. At the recent ABA Business Law Section Spring Meeting, the Hedge Fund Subcommittee gathered to discuss the recent amendments to Rule 206(4)-2 of the Investment Advisers Act (the "Custody Rule"), its implications to investment advisers, and practice tips to help clients comply with these amendments.

[More...](#)

**Secured Transactions: Practical Things Every Business Lawyer Should Know About UCC Article 9**
*Joseph H. Flack*

At the outset, Normal M. Powell captured the complexity of the law secured transactions. He said, "You can spend hundreds, if not thousands, of hours studying secured transactions and still have only scratched the surface" of this area of law. Powell made clear that the purpose of this panel was to cover only some of the core concepts in secured transactions. The Uniform Commercial Code committee of the ABA's Business Section presented this panel as part of the Institute for the Young Business Lawyer. Janet M. Nadile and Kate A. Sawyer were the panelists and Powell moderated the panel as its chair. The panel showed excellent and extensive knowledge of the law in this area and provided plenty of apt examples to assist in understanding the various points made. This article summarizes key points made in their presentation and incorporates panel materials authored by the panelists.

[More...](#)
Upcoming Meetings for Young Business Lawyers

Section of Business Law

- **The Institute for the Young Business Lawyer**, held in connection with the 2011 Spring Meeting, ABA Section of Business Law. Boston, MA, April 14, 2011.

Young Lawyers Division


Get Published Now! Articles Needed!

Over 12,000 Young Business Lawyers Want to Hear From You! There are over 400,000 ABA members of which more than 57,000 are Business Law Section members, in addition to the general public, that will have access to your article through high ranking search engine results. Your article will also be memorialized on the ABA website. The Young Lawyer Committee is collecting articles for future newsletters which are circulated to our members worldwide. Please send your submissions to Eric Koester at eakoester@gmail.com.

Articles should be 1500 words or less, and on any topic of interest to young lawyers. From short scholarly articles, to practice tips, reviews/summaries of a Section program, life in the trenches, interesting pro bono projects, humorous looks at life and the law, or even how you balance work and personal life. We appreciate your help in making this newsletter a success.

Committee Leadership

**Committee Chairs:**

Chair: **Sherwin Simmons**

Vice-chairs: **Stephanie Cohen**

**Mac Richard McCoy**
Subcommittees:

Membership: David Kinman

Newsletter/Technology: Eric Koester

Pro Bono/Public Service: Mac Richard McCoy

Programming/Institute for the New Business Lawyer: L. Monty Garside

Social: Jennifer Hilsabeck

Richik Sarkar

Solo/Small Firm: Tracy A. Cinocca

International: Sajai Singh
THIRTEEN PRACTICAL TIPS FOR “CLOSING” THE DEAL

By Cara Bradley

"Closing" a transaction is one of the most important duties performed by a junior business attorney. A transaction is considered closed when all requisite documents have been negotiated, signed and delivered, any instruments or certificates have been exchanged, authorizations and consents are final and effective, and any funds have exchanged hands. The following checklist contains practical tips to help ensure your next closing will proceed in a smooth and orderly fashion.

1. Understand the Substance of the Transaction.

Before you can prepare for a closing, learn about the operative documents involved in the transaction. You must understand the intent of the parties entering into the transaction and the relationships between the parties prior to and after the closing. Is ownership of an entity changing? Are securities being issued? Will new entities be created or any existing entities dissolved?

2. Understand the Mechanics of the Transaction.

Decide what steps are necessary for the closing. Do one or more of the operative documents include schedules and exhibits that need to be prepared, and if so, who is the party responsible for their preparation? Do stock certificates need to be printed? Are there any certificates or UCC forms that need to be filed with federal, state or local authorities, and if so, where must those filings be made? Are Board of Directors votes, shareholder votes or other authorizations or consents required? Does either party need to provide audited financial statements or comfort letters, and if so, who is the person responsible for coordinating with the auditors? Which legal opinions need to be provided? Where and when should money be wired?

3. Determine If Any Regulatory Filings or Clearances Are Needed.

Regulatory filings, including any Hart-Scott-Rodino clearance for merger and acquisition deals, often involve a substantial amount of lead time to prepare the filing and to wait for governmental approval. Identify any regulatory filings or clearances that will be required early in the negotiations so that your closing is not held up.

4. Prepare a Detailed Closing List and Agenda.

Your closing list should lay out the timing and responsibility of each party to close the transaction. Carefully review each of the operative documents to create a list of closing items. Keep in mind that closing deliverables may appear throughout the document, not just in the closing conditions section. Confer with the attorneys on the other side and the client to determine if any special closing items need to be built into the list and to confirm that parties tasked with specific items are aware of their responsibilities. Modify and update your list as the negotiations continue. Build in lead time to get your documents signed in advance of the closing.
5. **Lay Out Any Items Required for Closing that Require Lead Time.**

Stay aware of any required notice periods to hold a Board of Directors or a stockholder meeting. Figure out whether your entities are currently in good standing, and if not, determine what needs to be done to bring them into good standing. Estimate how much time is needed to order and receive certificates from the Secretary of State. Coordinate with your client and their auditors if an audit opinion or a comfort letter needs to be delivered at closing.

6. **Establish the Basic Logistics for the Closing.**

Determine a projected date and time for the closing. Decide whether the closing will be "live" or completed by telephone or fax. Establish if there are deadlines for fund transfers. Establish if a "pre-closing" is needed to prepare for the closing and if so, ensure that you have enough time to have all documents signed in advance.

7. **Keep in Mind Which Parties Need to be Involved in the Closing.**

Know which parties need to approve any last minute changes to documents. Confirm that everyone can be reached by telephone, fax or courier on the date of the closing or make alternative arrangements. Be aware of travel schedules. Keep in mind that a signatory's assistant or secretary can be your best source for accurately and timely signed documents. Make sure to accommodate any difference in time zones.

8. **Collect Signature Pages from Your Client.**

Talk to the other parties about the number of original signatures that will be required from each signatory. Collect your signature pages early. Do not date the signature pages until you have confirmed when the closing will occur. If you send signature pages to another party prior to the closing, make sure you stipulate that the pages are held in escrow pending your release at closing.

9. **Prepare the Items that Your Law Firm Must Present at the Closing.**

Draft and review any legal opinions that your law firm will present at the closing. Make sure that the appropriate partners at your law firm have reviewed the opinion before it is signed. If your client or any other parties will pay legal fees in connection with the closing, make sure the legal bill is prepared and includes accurate time entries up to the date of the closing.

10. **Stay Organized.**

As closing items are completed, keep careful track of them. Establish a system for collecting and organizing final documents as completed, especially signature pages. Follow-up with your team to assess progress on closing items and identify any potential problems early in the process. Update closing checklists regularly to reflect the status of the deal. Keep your team and the attorneys on the other side apprised of the status of items and who is responsible for which tasks.
11. Solve Problems as they Arise.

If a problem arises, you must first identify it and understand how it affects the overall transaction. There are no strict rules about what will hold up a closing and what will not. Some items can be delivered "post-closing" so long as the parties agree and there is little or no risk to enforceability of the transaction. If you are faced with a problem, consult with other attorneys on your team and if appropriate, your client. Problems at closing can generally be divided into three categories:

- **Administrative Problems** require some non-substantive changes to the closing items or timing of delivery. Examples include accepting a faxed copy of a signature instead of an original copy, fixing numbering or a spelling errors post-closing, or holding onto signed and delivered documents until money is wired. These types of matters can generally be worked out between the parties and do not typically need to hold up a closing.

- **Substantive Problems** affect the validity or enforceability of the transaction. Examples include incomplete disclosure schedules, improper or incomplete corporate authorization, or the rejection of a certificate by the Secretary of State because of drafting errors. These items will usually delay a closing until the problem can be resolved. To avoid certain substantive problems, consider pre-clearing important and time sensitive documents with applicable state authorities.

- "**Show Stoppers**" will prevent the transaction from going forward as intended, even with modifications, concessions or waivers. Examples include the discovery of encumbered title to assets, improperly issued securities or the refusal of one or more parties to move forward. In this case, the closing cannot happen until the parties resolve the remaining open issues.

12. After the Closing Date, Prepare Closing Files as Soon as Possible.

After the closing has occurred, collect any remaining post-closing items while the transaction is still fresh in your mind. Promptly prepare any blue sky filings or shareholder notices. Prepare and distribute closing binders to the appropriate parties and prepare your closing files with final copies of documents and all important correspondence.

13. When in Doubt, Always Ask for Help.

Other attorneys on your team or more senior lawyers at your law firm are more than willing to help you understand how a closing should proceed and are available to answer your questions. In addition, often paralegals at your firm will have been through literally hundreds of closings and will be able to answer many questions about the more administrative aspects of a closing.

*About the Author:* Ms. Bradley is an attorney in the Business Department at Choate, Hall & Stewart LLP in Boston. She is a member of the American Bar Association Young Lawyers Division and Business Law Section.
CUSTODY RULES FOR INVESTMENT ADVISORS

By Amy Rigdon

On December 30, 2009, the Securities and Exchange Commission (the "SEC") published its final rule amending the Custody Rule and related forms and rules. These amendments became effective March 12, 2010, and affect four main areas: (1) account statements; (2) additional surprise examinations; (3) physical custody of client assets; and (4) enhanced compliance and reporting obligations.

Who is affected? The Custody Rule applies to registered investment advisers ("RIAs"). In the amended Custody Rule, the definition of "custody" has been expanded to specifically include RIAs that have related persons who hold or are authorized to possess client funds or securities in connection with the advisory services provided by the RIA to its clients. This expansion is a significant departure from the SEC's practice of not attributing custody of client assets held by a related person of an RIA if the related person was operationally separate. The term "related" means a person directly or indirectly controlling, controlled by, or under common control with the RIA. Thus, RIAs who are a part of multi-service financial organizations may have "related person" custodians that are banks and broker-dealers. While the amended Custody Rule still applies to only RIAs, unregistered investment advisers should be aware of the Rule given that they may have to register depending upon the outcome of the proposed financial reform legislation (e.g. Dodd Bill).

Changes to Custody Rule (New Requirements)

Account Statements. Under the amended Custody Rule, the qualified custodian must send account statements on a quarterly basis directly to an RIA's clients. The RIA may send an additional account statement to its client, but the statement must include a legend asking the client to compare this statement to the one from the qualified custodian. Additionally, the RIA must form a reasonable belief that the qualified custodian is sending the account statements directly to clients. The reasonable belief must be formed after "due inquiry." Notably, even if a client receives its quarterly accountant statements electronically from the custodian, the RIA must still form a reasonable belief after due inquiry that the clients are receiving those statements.

Neither the Custody Rule nor its adopting release prescribes a particular method to satisfy "due inquiry." The adopting release specifically states that an RIA cannot satisfy its "due inquiry" obligation if the custodian merely makes the clients' account statements available on its website for the clients to access.

Practice Tip: An RIA will probably satisfy its "due inquiry" if the custodian emails a link to electronically access the statement to the clients and includes the RIA as a "cc" recipient on each email.

Annual Surprise Examination. RIAs with custody of client assets generally are subject to annual surprise examinations by independent public accountants. The amended Custody Rule includes three exceptions from this requirement. First, the requirement does not apply to RIAs that (1) maintain client funds and securities at a qualified custodian and (2) have custody solely because of the RIA’s authority to
deduct advisory fees from client accounts. Be aware that this exemption does not apply if the RIA has custody for any additional reason.

Second, the surprise examination requirement is deemed fulfilled for an RIA of a private pooled investment vehicle if (1) such vehicle undergoes an annual financial statement audit by an independent public accountant who is registered with and subject to inspection by PCAOB; (2) such audited financial statements are prepared in accordance with GAAP; and (3) the audited financial statements are distributed to the fund’s investors within 120 days after the end of the fiscal year (or 180 days for fund-of-funds). This second exemption is significant for RIAs of hedge fund and other private funds because it allows those RIAs to not only be exempt from the surprise examination but to also be exempt from the requirement to have a custodian send quarterly annual account statements to investors. Accordingly, if an RIA of a private pooled investment vehicle complies with this annual audit exemption, the requirements to deliver quarterly account statements and undergo surprise examinations do not apply to the RIA. Please note that this exemption is available only to RIAs’ advisory services provided to clients that are pooled investment vehicles and not any advisory services provided to another type of client.

**Practice Tip:** Not all PCAOB-registered accounting firms are regularly inspected by the PCAOB. You should inform your RIA-clients to ensure that the engagement letter with their accountant includes a representation that the accountant is both registered and inspected by the PCAOB. Additionally, this requirement applies to audits for fiscal years beginning on or after January 1, 2010.

Third, the surprise examination requirement is waived if the RIA is deemed to have custody of client assets *solely* because a related person is holding the assets and the related person is "operationally independent" of the RIA. The SEC presumes that related persons are not operationally independent, which makes it difficult for RIAs to use this exemption. Nevertheless, an RIA may rebut this presumption by demonstrating that certain conditions apply to the related person. Note that the presumption cannot be rebutted if the RIA has custody for additional reasons, and in such case, the RIA would be subject to the surprise examination requirement.

**Internal Control Report.** If client assets are held by an RIA or a related person, the RIA must obtain, or receive from the related person, a report of the internal controls relating to the custody of those assets from an independent public accountant. This requirement exists whether or not the related person is operationally independent; however, an RIA who maintains custody of privately offered securities is not required to obtain an internal control report unless the RIA also acts as qualified custodian with respect to other client funds or securities.

The RIA must receive the first internal control report within six months of becoming subject to this requirement. For RIAs subject to the requirement as of the Custody Rule’s effective date, the deadline to obtain an internal control report is September 12, 2010. RIAs must maintain copies of these internal control reports for five years.

In the case of a private pooled investment vehicle, if the pooled vehicle’s assets are maintained with a qualified custodian that is either the adviser to the pool or a related person of the adviser, then the RIA must obtain an internal control report from the related person. This requirement applies whether or not the RIA has fulfilled the surprise examination requirement by distributing audited annual financial statements.
**Recommended Compliance Policies.** The adopting release recommends certain policies and practices for RIAs to comply with the new Custody Rule. In addition to those recommendations, the Subcommittee discussed additional best practices. Some of those best practices for RIAs include:

- Conduct background and credit checks on the RIA’s employees who will have access to client assets;
- Require the authorization of two or more employees to transfer assets in and out of a client's account;
- Limit the number of employees who are permitted to interact with custodians regarding client assets and rotate such employees on a periodic basis;
- If the RIA also serves as a qualified custodian for client assets, segregate the duties of its advisory personnel from those of custodian personnel to impede any one person from misusing client assets;
- Track the status of the auditor;
- Establish policies to track the due inquiry supporting the RIA’s belief that custodians have sent quarterly account statements to client;
- Establish policies to document the reasons the RIA believes its related person is operationally independent;
- Prohibit employees from becoming trustees for client assets or obtaining powers of attorney for clients to prevent the RIA from inadvertently being deemed to have custody of client assets; and
- Most importantly, ensure that the RIA’s chief compliance officer has access to information on relevant matters so that he or she may enforce these policies and practices.

Lawyers with clients affected by the new Custody Rule should tell their clients to anticipate more detailed reporting and recordkeeping obligations in these areas. The SEC has announced that in light of these amendments Form ADV Part 1 will be amended to require RIAs to report more detailed information about their custody practices, to identify the accountants that perform audits or surprise examinations and that prepare internal reports, and to identify related persons that serve as qualified custodians. For RIAs that use a related person as its custodian, the RIA must also report whether it has determined that its related person is operationally independent and thus is not subject to the surprise examination requirement. RIAs can expect to provide these responses to the revised Form ADV in their annual amendments beginning January 1, 2011.

**About the Author:** Amy R. Rigdon is an associate Orlando, Florida office of Holland & Knight. Ms. Rigdon practices in the area of corporate and securities law. Her practice includes investment management, mergers and acquisitions, general corporate law, and litigation. Specifically, her experience includes forming and providing counsel to investment advisers and onshore and offshore hedge funds.
By Joseph H. Flack

At the outset, Normal M. Powell\(^1\) captured the complexity of the law secured transactions. He said, “You can spend hundreds, if not thousands, of hours studying secured transactions and still have only scratched the surface” of this area of law. Powell made clear that the purpose of this panel was to cover only some of the core concepts in secured transactions. The Uniform Commercial Code committee of the ABA’s Business Section presented this panel as part of the Institute for the Young Business Lawyer. Janet M. Nadile and Kate A. Sawyer were the panelists and Powell moderated the panel as its chair. The panel showed excellent and extensive knowledge of the law in this area and provided plenty of apt examples to assist in understanding the various points made. This article summarizes key points made in their presentation and incorporates panel materials authored by the panelists.\(^2\)

1. **Importance of the Security Interest Process**

This segment addressed the reasons that a creditor should take a security interest. The principal reason is so that a creditor has priority over competing creditors if the debtor files bankruptcy. Without a security interest, a creditor will not even be at the dinner table with other secured creditors but will be out in the cold with the unsecured creditors. Examples of unsecured creditors include trade creditors, landlords, and senior unsecured note holders.

Nadile provided an excellent example illustrating the importance of a creditor having a security interest. The example showed how priority of secured claims in bankruptcy works. The example assumes the debtor enters bankruptcy with $200 million in assets and $500 million in liabilities. The debtor’s assets are receivables ($50 million), inventory ($50 million), equipment ($50 million), and real property ($50 million), and the debtor’s liabilities are unsecured trade debt ($100 million), senior unsecured notes ($200 million), and bank debt ($200 million). If all claims are unsecured, then a creditor’s recovery is 40 cents on the dollar, or $80 million.\(^3\) If the Bank Creditor is secured only by receivables and inventory, its recovery will about $125 million.\(^4\) If, however, the Bank Creditor is fully secured by all the debtor’s assets, then its recovery will be $200 million.

Another reason that creditors should have a security interest is that having fully secured status can make post-petition interest and expenses available to the creditor in the debtor’s bankruptcy. A

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\(^1\)Partner, Young Conaway Stargatt\& Taylor, LLP, Wilmington, DE. Powell chaired this panel.

\(^2\) For the complete materials and audio for this panel, visit the Meetings Portal of the ABA Business Section’s website.

\(^3\) Divide the debtor’s total assets of $200 million by the debtor’s total liabilities of $500 million.

\(^4\) Bank Creditor’s recovery is calculated by adding $100 million (the portion of the debt secured by receivables and inventory) and $25 million, the Bank Creditor’s pro rata portion of the remaining assets of the debtor (i.e., 25% of the remaining $100 million in assets). The pro rata amount is calculated by dividing $100 million (the remaining unsecured portion of Bank Creditor’s debt) by $400 million (the total other debt not including the secured portion of Bank Creditor’s debt) and then multiply that by the remaining assets of $100 million.
security interest also allows the creditor more control over the debtor in bankruptcy. Having a security interest in the debtor’s deposit accounts and cash allows the creditor some control the debtor’s the cash collateral position.

A security interest also affords creditors the valuable right to foreclose on or sell collateral and apply the proceeds to repay the debt, but, in bankruptcy, this right is subject to the automatic stay, from which the creditor would be required to seek relief. The main point is that having a perfected security interest gives a secured creditor a whole lot more than would be available without one.

2. Legal Framework Governing Security Interests

The most important statute governing security interests is the Uniform Commercial Code (UCC), a uniform statute adopted fairly uniformly in the 50 states and territories. The National Conference of Commissioners on Uniform State Laws (NCCUSL) drafted the UCC, which is a model act that is not law. Each state, however, after making some modifications or changes, has adopted the UCC as law. Always check your state’s version of the UCC.

Articles 8 and 9 of the UCC contain the vast majority of rules governing the creation, perfection, and priority of security interests. Article 8 governs ownership and transfer of securities and other financial assets, but security interests in such assets are governed by Article 9. Article 9 governs security interests, and applies to any transaction that creates a security interest in personal property.\(^5\) Personal property is not defined in Article 9 but is just about everything other than real property, including goods, inventory, equipment, accounts, documents, and instruments, for example. Intellectual property is a valuable type of collateral subject to security interests as well. The UCC doesn’t cover other types of collateral. The big exception is real property. Each state has its own non-uniform real property law governing the creation, perfection, and priority of security interests (e.g., mortgages and trust deeds) in land and improvements.

Fixtures are goods that are semi-permanently attached to real property. They are “goods that have become so related to particular real property that an interest in them arises under real property law.”\(^6\) Examples include fireplaces, shelving, and central air conditioning units and ductwork. Generally, the cases say that a fixture is that which has been affixed to the real property with the intention that it become a permanent and integral part. It is not possible for a lawyer to predict what a fixture is in advance of an issue over its characterization, so a lawyer should thus err on the side of caution and treat what could be a fixture both as a fixture and as non-fixture personal property.

Three key concepts to know in the area of secured transactions are (i) “creation” and “attachment” of security interests, (ii) perfection, and (iii) priority. “Creation” and “attachment” is the process by which the creditor obtains security interests in the debtor’s assets. “Perfection” is the process by which the creditor ensures its security interest will be effective against third parties—in particular, a bankruptcy

trustee and other creditors of the debtor. “Priority” means the relative rights of one creditor with a security interest in the debtor’s assets vis-à-vis other creditors with claims to the same assets. Such other creditors may include (a) creditors with security interests in the same assets, (b) purchasers of goods, chattel paper, or instruments, and (c) landlords under leases of real property to a debtor on which the debtor’s fixtures are located.

3. Creation of Security Interests

Security interests are created by a contract called a security agreement. A “security agreement” is any agreement that creates or provides for a security interest.7 A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral (usually pursuant to a security agreement).8 UCC § 9-203 lists the requirements for having a valid and enforceable security interest against the debtor in personal property subject to Article 9. A security interest is enforceable against the debtor and attaches only if:

(1) value has been given;
(2) the debtor has rights in the collateral; and
(3) the debtor has authenticated9 security agreement10 that provides a description of the collateral (although possession or control may also suffice).11

The description of the collateral in the security agreement is sufficient if it “reasonably identifies what is described.”12 If a security interest attaches to collateral, then it also attaches to identifiable proceeds of that collateral, as well as any supporting obligations for that collateral.13 Examples of “supporting obligations” are a letter of credit rights supporting a receivable or a guaranty.14 “Proceeds” refers to whatever property is acquired upon the sale or other disposition of collateral.15

4. Perfection and Priority

Only a perfected security interest will have priority as against third parties. Even if a security interest is perfected, though, it may not have priority over all third parties. Without a properly perfected security

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7Id. § 9-102(a)(73).
8See Id. § 9-203(a).
9Powell explained that the term “authenticated” is a medium-neutral way of saying “signed.”
10The security agreement does not have to call itself a security agreement. It could be a paragraph buried in a loan agreement.
11Id. § 9-203(b).
12Id. § 9-108. This section gives suggestions of how to reasonably identify what is described. But it is not a reasonable description to say “all assets of the debtor” in the security agreement (though you might be able to use broader terminology in the financing statement).
13Id. §§ 9-203, 9-315(a)(2) (“a security interest attaches to any identifiable proceeds of collateral”).
14Id. § 9-102(a)(77).
15Id. § 9-102(a)(64).
interest, the creditor will have the status of an unsecured creditor in the bankruptcy of the debtor. Perfection thus gives a creditor priority over unsecured creditor’s claims in the bankruptcy of the debtor.

The general rule of priority is that the first creditor to (a) perfect, or (b) file a financing statement (even if the security interest has not yet attached or other steps for perfection were not satisfied at the time of filing) obtains priority as to the collateral. This rule, as many legal rules, is subject to many exceptions, including:

- purchase money liens
- perfection by possession or control (e.g., pledged stock)
- prior filings (need for UCC/title searches, including searches using the name of predecessor entities)
- statutory liens (need for landlord, bailee waivers)
- buyers of goods in the ordinary course of business (who take free of perfected security interests)
- perfection of another party’s security interest in goods represented by negotiable documents
- assets acquired by debtor subject to liens created by the prior owner (diligence on names of prior owner)
- proceeds of another party’s collateral
- federal tax liens in certain circumstances

Achieving perfection of a security interest, then, does not eliminate the risk in certain circumstances that competing claims could take priority.

In addition, some forms of perfection can be better than others as to certain collateral. Where perfection by more than one way is permitted, perfection by possession or control usually trumps perfection by filing. Furthermore, bankruptcy-related risks can cause a party to lose priority despite having perfected its security interest. One type of bankruptcy risk is the preference risk where transfers within a certain period of time before a bankruptcy filing are avoided by the bankruptcy trustee. Delayed UCC filings or after-acquired property can implicate this preference risk.

For UCC Article 9 collateral, perfection can be effected in several ways: by filing a UCC financing statement, by possession of the collateral, or by control of the collateral. The method of perfection depends on the type of collateral. Security interests in some types of collateral can only be perfected one way, but security interests in other types can be perfected in more than one way. For example, a security interest in goods can be perfected either by filing a UCC financing statement or by taking possession of the goods. A security interest in the debtor’s accounts or general intangibles is

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16 There are exceptions to these two forms of perfection of security interests in goods. One example is perfection of security interests in vehicles, which is governed in most states by certificate of title statutes under which perfection occurs by noting the lien on the certificate of title.

17 An “account” includes a broad range of the debtor’s rights to payment. See UCC § 9-102(a)(2). A “general intangible” is defined in UCC § 9-102(a)(42) and includes payment intangibles (a general intangible under which the account debtor’s principal obligation is a monetary obligation) and software.
perfected in only one way—by filing a UCC financing statement.\textsuperscript{18} Similarly, a security interest in money can only be perfected by one method—taking possession of that money.\textsuperscript{19}

Filing a UCC financing statement usually occurs at a central filing location, such as the secretary of state’s office of the state whose laws govern perfection. For example, a creditor should file its financing statement in the Delaware Secretary of State’s office to perfect a security interest in a Delaware corporation’s receivables, inventory, or general intangibles. Fixture filings should be filed in the real estate records of the counties in which the real property is located—the same office where a mortgage or deed of trust would be recorded. Preparing a UCC-1 financing statement form must be done with great care to avoid any errors, especially in the debtor’s legal name. An error in the debtor’s legal name has the potential of causing the creditor’s security interest to lose priority.

5. Overview of the Collateral Process

The first step in the collateral process is to determine the collateral package. The lawyer’s role is to identify costs and legal obstacles and assist in identifying the debtor’s key assets. An important question is how much collateral is enough? The lawyer should consider that the creditor will be entitled to post-petition interest in bankruptcy if “over-collateralized,” meaning that the collateral value exceeds the debt. Another consideration is that collateral values may change after closing, which may erode initially strong collateral coverage. For example, the value of the collateral if the debtor is a going concern will be drastically different from such value if the debtor is in liquidation.

The lawyer’s goal should be to develop a collateral plan, consisting primarily of the checklists for the steps needed to create and perfect security interests. A perfection certificate elicits information needed to perform searches, identify signatories to collateral documents, prepare filings and take other necessary perfection steps. A list of loan parties should also be made identifying the parties to sign the security agreement. In addition, the parameters for lien searches should be well defined, and a list of lien searches should be made organizing the searches by entity and jurisdiction and ordering the searches from the search company. The lawyer should review the search results, identifying problematic liens and taking necessary action, such as arranging for UCC-3 terminations.

6. Revisions to Article 9

In 2008, NCCUSL and the American Law Institute formed an Article 9 Review Committee to consider whether a drafting committee should be formed to propose revisions. A joint review committee (JRC) was formed to address certain issues, and the JRC is currently drafting amendments to the statutory text and comments for consideration by NCCUSL and the ALI. Powell covered this segment of the panel, and the panel materials can be referenced for further information.

About the Author: Joseph H. Flack is an associate in the Anchorage, Alaska office of Birch Horton Bittner & Cherot PC. Mr. Flack’s practice includes commercial and real estate transactions, secured lending and related litigation.

\textsuperscript{18}See UCC § 9-310.
\textsuperscript{19}Seeid. § 9-312(b)(3).