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## MEMORANDUM

TO: Clients and Friends

FROM: David Ley Hamilton, Esq.  
David A. Harris, Esq.

DATE: February 13, 2001

RE: Delaware Enacts Revised Article 9 of the Uniform Commercial Code

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Last summer the Delaware legislature unanimously enacted revisions to the Delaware Uniform Commercial Code that put into effect (with some modification) the Revised Article 9 of the Uniform Commercial Code. Delaware's governor signed the bill, and Delaware joined the growing list of states where Revised Article 9 will take effect on July 1, 2001.<sup>1</sup>

The revisions to Article 9 are the first major revisions to that article since 1972. They include significant changes to substantive rules and to the procedures applicable to creation and perfection of security interests in personal property. Revised Article 9 significantly expands the scope of collateral and transactions covered, clarifies and modifies rules for attachment,

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<sup>1</sup> As of this writing The National Conference of Commissioners on Uniform State Law web site indicates that 29 states have adopted Revised Article 9 and legislation has been introduced in 13 of the remaining states.

perfection and priority (including choice of law rules for perfection--*i.e.*, where to file) and should generally improve and modernize the system for filing financing statements.

Although the basic concepts of security interests under the Uniform Commercial Code are not dramatically changed and the general approach of Revised Article 9 follows that of current Article 9, there is a significant volume of material to digest and apply under Revised Article 9. As has been our practice in Delaware for at least the last two decades, a Subcommittee of the Delaware Bar Association's Commercial Law Section embarked upon a comprehensive review of the revisions to Article 9 promulgated and adopted by the Permanent Editorial Board for the Uniform Commercial Code (with support of the American Law Institute and The National Conference of Commissioners on Uniform State Laws). While Delaware's enactment of Revised Article 9 is substantially the same as the Permanent Editorial Board's uniform draft (herein the "Uniform Draft"<sup>2</sup>), the Subcommittee recommended some non-uniform provisions, all of which are a part of Delaware's Revised Article 9.

In this memorandum we describe the Delaware changes from the Uniform Draft and describe some of the fundamental concepts included in the remarkably (but necessarily) complex transition rules.<sup>3</sup> (Because Delaware did not create any official legislative history, readers who may need to be aware of Delaware's non-uniform provisions will want to keep this memorandum with their UCC materials.)

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<sup>2</sup> We refer to Revised Article 9 and current Article 9 where it is not necessary to distinguish between the Uniform Draft and Delaware's enactment.

<sup>3</sup> This memorandum is not intended as a comprehensive analysis of Revised Article 9 or the transition rules. There are already excellent detailed treatments available. *See, e.g., The New Article 9* (Corinne Cooper ed., A.B.A., 2d ed. 2000); Harry C. Sigman & Edwin E. Smith, *Revised U.C.C. Article 9's Transition Rules: Insuring a Soft Landing*, 55 Bus. Law. 1065 (May 2000) and 55 Bus. Law. 1763 (August 2000).

## **The Delaware Non-Uniform Changes**

1.     Definition of “Account”. Earlier versions of Article 9 defined “Account” in a way that did not include credit card accounts. Because of Delaware’s credit card industry and the need to facilitate transactions involving rights to payment under credit cards, a definition of “credit device account” was added to Delaware’s version of Article 9 in 1990. The Uniform Draft significantly modifies the definition of “account” under current Article 9 to include a right to payment of a monetary obligation arising out of the use of a credit or charge card. Our Subcommittee determined that, given the thousands of transactions conducted in Delaware in reliance on this non-uniform provision, the definition of “credit device account” set forth in Delaware’s current version of Article 9 is more properly tailored to Delaware’s credit card industry provision and should be preserved. Accordingly, the definition of “credit device account” is included as new Section 9-102(a)(27A) and the definition of “account” set forth in Section 9-102(a)(2) was revised to include credit device accounts. These changes necessitated a conforming amendment to the definition of “chattel paper” in Section 9-102(a)(11).

2.     Location of Registered Organization Organized under Federal Law. The new filing rules under Revised Article 9 generally follow the debtor’s “location” (regardless of where the collateral is located). Section 9-307(f) of Revised Article 9 sets forth general rules for determining the location of a registered organization organized under the laws of the United States. Our Subcommittee determined that Section 9-307(f)(2) of the Uniform Draft, which provides that such an organization is located in the state that it designates if the law of the United States authorizes it to designate its state of location, may be ambiguous as applied to certain registered organizations (*e.g.*, national banks) because the language does not make specific reference to designation of a main office or home office as constituting a designation of location. Because of the frequency with which some registered organizations organized under federal law

engage in securitization transactions in Delaware, our Subcommittee decided that the rule regarding where they are located for filing purposes should be clarified and added an appropriate sentence to the end of Section 9-307(f) providing that, for purposes of Section 9-307(f)(2), if a registered organization designates a main office, home office or other comparable office in accordance with United States law, such registered organization is located in the state in which such main office, home office or other comparable office is located.

3. The Test for “Seriously Misleading” Error in Name of Individual Debtor.

Under Section 9-402(8) of current Article 9, a financing statement naming an individual debtor but containing errors (*e.g.*, in the stated name) is effective if the errors are “not seriously misleading.” The determination of whether errors are “not seriously misleading” is left to judicial determination. Under Section 9-506 of the Uniform Draft, a financing statement containing errors is effective only if the filing office’s standard search logic would disclose the financing statement notwithstanding the error using a search under the debtor’s correct name. While this revision has the advantage of removing the issue from a subjective determination by the courts, it does create a scenario of potentially harsh and unpredictable results if the exact name of the debtor is not literally correct. Considering the difficulty of ascertaining the exact name of debtors who are individuals in certain cases, our Subcommittee decided to modify Section 9-506(b) so that the “not seriously misleading” standard as determined by the courts under existing law is retained with respect to debtors who are individuals.

4. Rejection of Organizational Filings. Section 9-516(b)(5)(C)(ii) of the

Uniform Draft requires that if the debtor is an organization (*e.g.*, a corporation), a financing statement must provide, among other things, the debtor’s organizational identification number. Under Uniform Draft Section 9-520(a), the filing office must reject a filing that does not include this information. Our Subcommittee determined that this would create an inappropriate trap for

the unwary, and that the requirement under current law and the Uniform Draft that a financing statement include the debtor's name and address together with the new requirements under Revised Article 9 that the financing statement indicate whether the debtor is an individual or organization, the type of organization and the jurisdiction of its organization provide sufficient information. Accordingly, Delaware Section 9-516(b) does not include the Uniform Draft's requirement for an organizational identification number. In the interest of uniformity, Delaware's statutory form of financing statement includes the field for organization identification number set forth in the form provided in the Uniform Draft but indicates that this information is optional for Delaware filings.

5. Standards for Timely Performance by Filing Offices. Section 9-519(h), Section 9-520(b) and Section 9-523(e) of Revised Article 9 all pertain to standards for timely performance by filing offices. Delaware's filing office will address these standards by filing office rules adopted pursuant to Section 9-526. Our Subcommittee determined that to preserve flexibility in the filing office rules, the "default" requirement of two business days to act in each of Sections 9-519(h), 9-520(b) and 9-523(c) of the Uniform Draft should be deleted. In addition, as a result of this change, Section 9-519(i) of the Uniform Draft is not included in Delaware's version of Revised Article 9.

6. Public Availability of Records. Section 9-523(f) of the Uniform Draft requires that the filing office offer for sale or license at least weekly copies of all records filed in it under Revised Article 9. At the request of the Delaware Secretary of State's Office, the public availability of records on a weekly basis is made permissive, not mandatory, under Delaware's Section 9-523(f).

7. Periodic Reports of the Filing Office. Section 9-527 of the Uniform Draft requires that the filing office report periodically to the governor or legislature on the operation of

the filing office. Our Subcommittee learned that many states had or would delete this section and decided that such reporting and requirements were better handled separately from Article 9 and thus decided, with the concurrence of the Secretary of State of Delaware, to delete this section from Delaware's version of Revised Article 9.

8. Special Transition Provision Regarding Trusts and Trustees. Under Section 9-705(c) of the Uniform Draft, financing statements for existing perfected security interests that would not be effective under Revised Article 9 remain effective until the earlier of their normal lapse date and June 30, 2006. Under Section 9-503 of Revised Article 9, a financing statement that lists the name of a trustee of a trust that is a debtor rather than the name of the trust itself would require a filing in order to list the trust as the debtor rather than the trustee of the trust (a continuation statement could accomplish this). Because there is an unusually large number of Delaware financings involving trusts as debtors (*e.g.*, leveraged lease, collateralized mortgage and credit card securitization transactions) that have financing statements naming the trustee as debtor, our Subcommittee decided to add Section 9-703(c) to the Delaware version of Revised Article 9, which operates to maintain the effectiveness of existing filings under Revised Article 9 without the need to change the name of the debtor from the trustee to the trust. Section 9-703(c) of the Delaware version expressly provides that continuation statements can be used to maintain such an effective existing filing.

9. Other Miscellaneous Changes. Our Subcommittee recommended a variety of clarifying changes that were adopted as part of Delaware's version of Revised Article 9 that do not change substantively the provisions of the Uniform Draft. In some cases the Subcommittee determined to include specific language from Official Comments to the Uniform Draft because, consistent with past practice, Delaware did not adopt the Official Comments as part of Revised Article 9. (*See, e.g.*, Section 9-340(d) which includes language taken from

Official Comment 2 to Uniform Draft Section 9-340.) To assure that this memorandum includes all of the Delaware changes from the Uniform Draft, the sections changed in non-substantive ways are listed below.

- Section 9-324(a)
- Section 9-324(c)(2)
- Section 9-324(e)(2)
- Section 9-340(a)
- Section 9-340(d)
- Section 9-402
- Section 9-403(d)
- Section 9-520(a)
- Section 9-525(d)
- Section 9-608(a)(1)

### **A Very Brief Look at the Transition Rules**

Making fundamental changes to a uniform law as complex as Article 9 creates a progression of challenges in dealing with the transition to the new law. Some of the changes that make the transition rules of Revised Article 9 especially tricky are:

- Revised Article 9 changes the proper place of filing for financing statements for a substantial number of transactions;
- Revised Article 9 substantially expands the scope of Article 9 to cover additional types of collateral and transactions;
- Revised Article 9 provides new methods of perfection for certain types of collateral; and
- Revised Article 9 provides different priority rules and different choice of law rules governing perfection and priority.

The transition rules start from the assumption that there will be a common effective date of July 1, 2001 in each state. The transition rules then adopt the simple premise that what works under both current Article 9 and Revised Article 9, of course, continues to work under Revised Article 9. From there things get progressively complicated as the transition rules deal with circumstances where, for example, a security interest is created and perfected under current Article 9 but the steps taken to create and perfect the security interest under current Article would not be sufficient under Revised Article 9.

In general, a financing statement filed before the effective date of Revised Article 9 that is effective to perfect a security interest under current Article 9 remains effective under Revised Article 9 until the earlier of the time the financing statement would have ceased to be effective under current Article 9 or June 30, 2006. There are two methods for “continuing” a financing statement filed under current Article 9 to maintain priority dating back to the original filing date of the financing statement. If the financing statement was filed in the jurisdiction and filing office that is the correct place of filing to achieve perfection under Revised Article 9, the financing statement may be continued by filing a continuation statement under Section 9-705 of Revised Article 9 (a “True Continuation Statement”). A True Continuation Statement relates back to the original filing date of the financing statement for purposes of priority and operates to extend the effectiveness of the financing statement for an additional five-year period, commencing on the date that the financing statement would otherwise have lapsed. As with continuation statements under current Article 9, a True Continuation Statement may be filed only during the six-month period prior to the date that the financing statement otherwise would have lapsed.

If the financing statement filed under current Article 9 was filed in a jurisdiction or filing office that is not the correct place of filing to achieve perfection under Revised

Article 9, the financing statement may be continued only by filing an initial financing statement in lieu of a continuation statement under Section 9-706 of Revised Article 9 (an “In Lieu Financing Statement”). An In Lieu Financing Statement provides a vital link between the financing statement filed in the proper place for filing under current Article 9 and in the new proper place for filing under Revised Article 9. Said another way, it causes a migration of the financing statement from the old place for filing to the new place for filing. An In Lieu Financing Statement relates back to the original filing date of the financing statement for purposes of priority and extends the effectiveness of the financing statement for a five-year period commencing on its own filing date, rather than, as is the case with a True Continuation Statement, the date that the financing statement otherwise would have lapsed. Unlike a True Continuation Statement, an In Lieu Financing Statement is a new financing statement and may be filed at any time prior to the date the financing statement would cease to be effective (not just during the normal 6-month window for filing a True Continuation Statement). The filing of a True Continuation Statement with respect to a financing statement filed under current Article 9 will not continue the effectiveness of the financing statement unless the financing statement was filed in the proper place for filing under Revised Article 9.

Even a seasoned practitioner will be daunted by the complexity of the transition rules when reading them in the abstract. All of us (expert or otherwise) will work our way through the transition rules as they apply to specific situations we confront. Secured lenders, however, should now consider at least the following:

(a) Making modifications to existing security agreements and forms of security agreements. Modifications, for example, may be used to incorporate collateral descriptions that contemplate the changes in classifications of collateral under Revised Article 9. Security agreements could also be modified to include express authorizations for authentications

of financing statements as well as to include representations and warranties concerning the location of the debtor.

(b) Filing financing statements complying with the requirements of Revised Article 9 with respect to collateral that is not covered by current Article 9 but that can be perfected by the filing of a financing statement under Revised Article 9 (*e.g.*, commercial tort claims, health care insurance receivables, investment property and instruments).

(c) Filing financing statements that include an “all assets” description of collateral. Note, however, that “all assets” descriptions may not be effective under current Article 9 and would therefore not operate to perfect a security interest prior to the effective date of Revised Article 9.

(d) Taking steps to be certain that debtors’ names on financing statements are listed correctly in light of the very limited latitude for error in debtors’ names on financing statements under Revised Article 9.

(e) Filing In Lieu Financing Statements in connection with the filing of financing statements under current Article 9 prior to the effective date of Revised Article 9.

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