

The Effect of the Revised (1998) Article 9 Upon Real Estate Law

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The 1998 Revised Article 9 of the U.C.C. became effective in all but a handful of states on July 1, 2001. Within a year, all 50 states, plus the District of Columbia, were operating under R9, also called the 1998 Article 9. Remarkably few non-uniform amendments were added by the adopting jurisdictions.

The best source for the new article, with comments; the old article, with comments; the disposition and source tables; and essays comparing the new articles is **The New Article 9, Second edition**, edited by Corinne Cooper (2000), published by The Section of Business Law, The American Bar Association.

The new Article 9 keeps the concept of the unitary security interest and re-arranges the sections and their numbers, so that the sequence is more logical. It tries to clarify ambiguities in the text and comments. Above all, it tries to make secured transactions law capable of taking advantage of the technological advances of the last decade and probable advances of the next two or three decades.

(# items should be of special interest to real estate lawyers)

DEFINITIONS AND SCOPE

Useful new or revised definitions include:

UCC 1-201(37) “security interest”. This became part of the Code with the addition of Article 2A, effective now in almost all of the states. It replaced the old “intent of the parties” test for distinguishing between an Article 9 secured transaction in the form of a lease and a true lease. The new definition contains a four-pronged test that adds “economic realities” to the old “intent” test. Cf. UCC 2A-103(1)(j) on the definition of “lease”.

Debtor The revised definition, in R9-102(a)(28), expands the old definition a bit. The new “obligor” (defined in R9-102(a)(59)) is what we would usually call “the debtor,” while the new “debtor” covers even more people, presumably including sureties.

Goods R9-102(a)(44) contains a revised definition of “goods”, including a long sentence on computer programs.

Software R9-102(a)(75) is a NEW definition: “computer program and any supporting information provided”---but software does not include anything within the new definition of “goods”. “Goods” and “software” are mutually exclusive terms; “software” is, in fact, a subset of the former and continuing “general intangible” category. (Comment 4.a. and Comment 25, together, to R9-102.) “Smart goods”, such as cars with computer software, are “goods”, not “software.”

Purchase Money Purchase money security interest definitions include R9-103, which defines “purchase money collateral” and “purchase money obligation” in subsections (a) and (b). Comment 3, paragraph 2, indicates that a PMSI requires a close nexus between the acquisition of collateral and the secured obligation.

Account R9-102(a)(2) and (3): revised definition is a “right to payment for a monetary obligation” and then a long list, including “health care receivables” and “credit card receivables”. This is clearly an expansion of the old definition in former UCC 9-106 and picks up some assets currently regarded as “general intangibles.”

Proceeds, Cash Proceeds and Non-Cash Proceeds R9-102(a)(9), (58) and (64) are revisions of the old definitions in UCC 9-306(1). Comment 13 indicates they may have expanded the scope of “proceeds”. Is the scope of “general intangibles” necessarily diminished by the expansion of the scope of “account” and “proceeds”? Supposedly no.

*Agricultural lien R9-102(a)(5) defines this new term, which is apparently a modern version of a “crop lien”. R9-109(a)(2) indicates that “agricultural liens” are now inside Article 9. However, R9-109(d)(1) and (2) and Comment 3 suggest that landlord’s and non-agricultural liens are excluded from the scope of the new Article 9. This is particularly important for real estate lawyers who deal with farmland or represent developers who are buying farmland for subdivisions, etc.

Set-offs Set-offs are really cancellations of mutual debts, so they do not create a security interest. Set-offs are still excluded, but R9-109(d)(10) indicates that two types of set-offs are included: R9-340 on set-offs against deposit accounts and 9-404 allowing a debtor on an account, chattel paper or general intangible the right to raise claims and defenses.

Transfers of tort claims R9-109(12) continues the old exclusion from Article 9, but says that “commercial tort claims” are included in the new Article 9. Comment 15 says that after a judgment “and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and ceases to be a claim arising in tort.”

R9-102(a)(13) defines a commercial tort claim; it arises from a “business”, but cannot include a personal injury or death claim. Comment 10.b. to R9-102 says this new definition narrows the exclusion of tort claims from Article 9.

Payment intangible This is a completely NEW concept. R9-102(a)(61) says it “means a general intangible under which the account debtor’s principal obligation is a monetary obligation.”

A “general intangible”, formerly defined in UCC 9-106, is defined in R9-102(a)(42) as “any personal property, including things in action...” and includes “payment intangibles” and “software”, both new and newly-defined terms. Comment 5.a. to R9-102 suggests that a “general intangible” is “the residual category of personal property” and that both a “payment intangible” and “software” are sub-sets of “general intangible”—a very important comment. Supposedly the primary reason for creating this new concept was to facilitate sales of loan participations.

Deposit account; instrument; promissory note R9-102(a)(29) defines a “deposit account” similarly to the definition in former UCC 9-105(a)(e), but it excludes “investment property or accounts evidenced by an instrument.” R9-109(d)(13) excludes “assignment of a deposit account in a consumer transaction”, but includes other assignments of deposit accounts. See Comment 6 to R9-102.

R9-102(a)(47) defines “instrument” similarly to former UCC 9-105(1)(i), but excludes credit card receivables, among other things. The definition of “promissory note” in R9-102(a)(65) is new. Comment 5.e. to R9-102 says this definition is “necessitated by the inclusion of sales of promissory notes within the scope of Article 9”. Checks, however, are excluded.

Insurance Current UCC 9-104(g) excludes a “transfer of an interest in or claim in or under any policy of insurance.” The cases are mixed. R9-109(d)(18) is much the same, but does allow “health-care receivables” to be Article 9 collateral. Comment 13 to R9-109 says that this inclusion of “health-care receivables” narrows the exclusion of insurance.

R9-102(a)(46) defines a “health-care insurance receivable”, and Comment 5.a. says “it is a subset of the definition of ‘account.’ ” Does this new definition include governmental, as well as private, health-care insurance, e.g., Medicare and Medicaid?

Good faith R9-102(a)(43) revises the definition of good faith applicable in Article 9. The former definition is found in UCC 1-201(19): “honesty in fact.” (I say “is” because only a handful of states have adopted the new definition in Revised Article 1, currently making its way through the state legislatures.)

The new definition is similar to the definition of merchant good faith found in current UCC 2-103(1)(b), which adds “observance of reasonable commercial standards of fair dealing in the trade” to “honesty in fact”; however, the new definition for Article 9 drops “in the trade.”

In short, the obligation of good faith in the new Article 9 will be an objective standard of good faith and more closely resemble the obligation of merchant good faith than that of ordinary good faith. Will this “heightened” definition of good faith change the way secured parties and debtors behave towards each other? This heightened definition is, in fact, the definition of “good faith” that is fast replacing that of “ordinary” good faith in each article of the Code as each article is being revised, including Article One.

*REAL PROPERTY DEFINITIONS AND SCOPE

Clearly, a direct security interest in real estate is still excluded, but a lot of security interests in certain rights in or affecting real estate may be within Article 9.

Realty paper This is a security interest in a mortgage on real estate. R9-102(a)(32) defines an “encumbrance”, and R9-102(a)(55) defines a “mortgage”. Comment 17 indicates they are carry-overs from the current definitions. The former definition was in UCC 9-105(1)(j) and read:

“Mortgage” means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like.

The new definition reads:

“Mortgage” means a consensual interest in real property, including fixtures, which is created by a mortgage, trust deed, or similar transaction.

Probably all that this new definition does is specify that fixtures can be the subject of a mortgage.

R9-109(b) hints that “one generation away from real estate” deals are in Article 9. R9-109(d)(11), Comment 7, indicates that a security interest in a mortgage on real estate must have an “equally effective security interest in the secured obligation”.

Rental payments from leases of real estate Former UCC 9-104(j) excluded leases of land or rents arising from leases of land—yet the rents are really “accounts receivable” from a business. Receipts from hotels and other places of lodging are “rents”. The case law on whether they are inside Article 9 or not has been mixed, but apparently most courts have said these were accounts receivable. Bills for food, service, etc., are often on a hotel bill. Comment 10 to R9-109 says “rents from land” are excluded, but the new definition of “account” in R9-102(a)(2) may now be broad enough to cover hotel rents as “accounts receivable” from a business, ending the dispute.

Should a secured party still file in both the real estate office and the Article 9 (Secretary of State’s) office? The case law on the cusp of R9 indicated that courts were becoming more liberal in deciding whether “semi-real estate” cases really fell under Article 9. For example, there was In re IT Group, Inc., Co., 307 B.R. 762, 42 Bankr. Ct. Dec. (CRR) 226, 53 U.C.C. Rep. 2d 125 (D. Del. 2004). The collateral was the proceeds on a land sale contract. The court held this was an Article 9 transaction, not a real property transaction. Presumably, this trend will only continue under revised Article 9, but the wise attorney will still advise filing in both offices unless it is crystal clear that the transaction is an Article 9 transaction or a real property transaction.

CREATION AND PERFECTION OF A SECURITY INTEREST

There are the same four requirements for the creation of a security interest—former UCC 9-203 and R9-203:

- 1) a security agreement;
- 2) possession of the collateral by a secured party (pledge) or a writing containing the debtor's signature, a description of collateral and perhaps language "granting" a security interest);
- 3) secured party gives "value" (UCC 1-201(44)); and
- 4) debtor has "rights in the collateral".

Description R9-108(a) retains the former standard of "sufficiency of the description" in former UCC 9-110; subsections (b) and following expand the definition with examples. Subsection (c) says that a "supergeneric" description, such as "all assets", is not specific enough. According to the case law, that has always been true.

Debtor's rights in the collateral R9-203(b)(2) requires that "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party" before a security interest can attach. Comment 6 to R9-203 says that "the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be." Presumably, this reflects acquiescence in the expansion of a "debtor's rights in the collateral" suggested almost twenty-five years ago by Professor Ralph C. Anzivino of Marquette U. Law School, "When Does a Debtor Have Rights in the Collateral Under Article 9 of the Uniform Commercial Code?", 61 Marq. L. Rev. 23 (1977). Certainly this is broader than the "identification" concept favored by Professor Grant Gilmore in his landmark treatise on secured transactions in 1965 (1 G. Gilmore, Security Interests in Personal Property 353 (1965)).

Record R9-102(a)(69) says that a "record" is "retrievable in perceivable form" (See Comment 9.a.) Cf. the definition of "writing" in UCC 1-201(46)—an "intentional reduction to tangible form." Clearly, there is an attempt to bring e-commerce up to date in secured transactions. Is e-mail a "writing"? a "record"?

Who can, must or should file?

R9-310 says, in effect, that the only type of collateral in which perfection by filing is impossible is "money." Formerly, a secured party could perfect only by possession security interests in both "money" and "instruments". This change allows a secured party to perfect a security interest in an "instrument" by filing a financing statement. This is very important if you don't know if the collateral is an "instrument" or a "general intangible" or a combination of both.

R9-313 and its Comment 2 list many mandatory filing requirements, including the new "payment intangibles." (Formerly, security interests in "general intangibles" had to be perfected by filing anyway, and "payment intangibles" are a subset of "general intangibles".)

R9-311 deals with federal law. It may indicate that security interests in intellectual property can be perfected by filing according to the federal system for that type of intellectual property, but this is not certain. The problem in the former Article 9 may continue.

Name of the debtor and secured party

Financing statement issues of this sort are covered in R9-502, R9-503 and R9-509. They assume the existence and greater use of computerized records.

R9-502(a) requires that the financing statement give the name of the debtor and the name of the secured party and “indicate” the collateral covered. The requirements of the addresses of the secured party and debtor and the signature of the debtor are eliminated. Comment 3 says that there must be a “required authorization” to file by the debtor, but adds that signing a security agreement is indication of that authorization. (R9-509).

R9-503 deals with the names of the secured party and debtor. Subsection (a)(1) speaks to a “registered organization”—primarily a corporation—and says that the name in the “public record” or “legal name” must be given. Subsection (b) says that there is no need for a trade name, and subsection (c) says that a trade name alone is insufficient to indicate a name. Subsection (d) suggests that a failure to indicate a “representative capacity” does not affect sufficiency regarding the name, while subsection (e) indicates that multiple names of debtors and secured parties are sufficient.

Description/indication of collateral

Under former Article 9, the secured party usually just “blocked and moved” the description of the collateral from the security agreement to the financing statement. Supergeneric terms, such as “all assets” or “all personal property”, were insufficient. R9-504 specifically allows this type of supergeneric description.

Will lawyers still “block and move”, or will they hastily write in “all assets of the debtor”? The limited surveys done since 2001 indicate that most still “block and move”—especially conservative bank counsel—but that a significant number of attorneys write in “all assets of the debtor” and thereby encourage subsequent creditors of the debtor to call them for further information about the loan.

An interesting development concerns California’s Secretary of State. As of April, 2004, that officer was refusing to accept “all assets of the debtor” on financing statements. This is in direct contravention of R9.

R9-521 contains a uniform form financing statement—which in turn specifies the addresses of the secured party and the debtor. Will almost all secured parties use this uniform form throughout all jurisdictions?

*Where to file a financing statement

Intrastate filings were covered in former UCC 9-402, which offered the states three choices. R9-501 has a special rule for transmitting utilities and then indicates that a central office, almost universally the Office of the Secretary of State, will receive all other filings.

However, R9-501(a) specifies instead “the office designated for the filing or recording of a record of a mortgage on the related real property, if: (A) the collateral is as-extracted collateral or timber to be cut; or (B) the financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures”

If “the collateral is goods that are or are to become fixtures and the financing statement is not filed as a fixture filing”, then the Secretary of State’s office is the venue (R9-501(a)(2)).

Interstate filings, the bane of so many secured parties and their lawyers, were covered in the complicated provisions of former UCC 9-103. Now R9-301(1) specifies the “location of the debtor”, and R9-302 through R9-306 cover special situations.

“Location of the debtor” is explained in R9-307. A “registered organization”, defined in R9-102(a)(70), includes corporations, limited liability corporations and limited partnerships. Comment 11 to R9-102 indicates that it excludes “general partnerships.” Will the old “location of the debtor” cases under former UCC 9-103 carry over and “inform” the location of the debtor problems in R9-3?

Problems with Electronic Filing

Revised Article 9 envisions that all filings will be made electronically within a few years. The Secretary of State’s offices around the country have been making progress in facilitating this. According to Trish Bogenrief, in her article “Electronic Filing of UCC Financing Statements”, in the December 2004 issue of the American Bar Association’s Business Law Section’s “Commercial Law Newsletter”, 34 states use electronic filing options. In offices that accept XML (extensible mark-up languages) the sender receives confirmation of the filing within a minute or so, around the clock. According to her, the best option allows for bulk filing through a “third party link”, available on XML in nine states and on an EDI basis in Texas. Presumably the remaining 40 states and other jurisdictions will follow suit.

However, she also writes that the local filing offices, where real property related financing statements are filed, are not developing electronic filing. Presumably, couriers will still be necessary for delivery to these local offices, as they are for filing other real property transactions. She recommends consulting the “RA9 Quick Reference Guide”, available at www.incspot.com.

*Fixture filings

Formerly, the only definition of a “fixture” was found in case law, and UCC 9-313 governed fixture filings. R9-109(a)(a)(1) specifies that “fixtures” are within the scope of Article 9.

R9-102(a)(40) and (41) contain the new definitions of “fixture” and “fixture filing.” Subsection (41) reads:

“Fixtures” means goods that have become so related to particular real property that an interest in them arises under real property law.

Comment 18 to R9-102 is important here. It suggests the definition is “unchanged”, but note that the definition still depends on local, *i.e.*, state law. In Illinois, for example, there is a definition in the State Finance Act, 30 ILCS 105/24.8: “...’fixtures’ shall mean any item of tangible personal property which is acquired with the intention of attaching it to real estate so that it becomes a part thereof.”

The careful lawyer will consult the statutory and case law definitions of “fixtures” in his or her state before proceeding with a fixture filing. Local law will control because “real property law” is local.

R9-334 contains the rules on priorities for fixtures and fixture filings; they continue the same rules as in former UCC 9-313. (See Comment 2 to R9-334.)

*Perfection by Possession

Under former UCC 9-305 a secured party could perfect his security interest by taking possession of the collateral. R9-313 apparently continues the present provision, but subsection (h) appears to validate possession by a secured party’s agents and by escrows, which has been a problem for several decades. A companion provision, R9-314, discusses the concept of “control”.

Automatic Perfection

R9-309 continues most of the provisions on automatic perfection, *i.e.*, perfection upon attachment without any filing or taking possession, contained in former UCC 9-302. However, it specifically adds “payment intangibles” and the sale of “payment intangibles” to the list, which is expanded in subsections (3) through (13).

Temporary Perfection

The former provisions were UCC 9-302(1)(b) and 9-304(4) through (6). R9-312 supersedes them and changes the twenty-day rule to a twenty-one-day rule. It hints that temporary perfection applies only in “special industries”, which presumably means the letter of credit business.

Perfection of a Security Interest in Proceeds

The former provision was UCC 9-306 and specified either ten or twenty days as the grace period. R9-315 extends that grace period to twenty-one days.

Title Insurance

First American Title Company began offering "Eagle 9", which is supposedly similar to a mortgagee's policy of title insurance. However, it is designed for secured lenders in a commercial loan transaction and insures the attachment, perfection, and priority of an Article 9 security interest. Other title companies are now issuing competing policies.

DEFAULT AND PRIORITIES

What is a default?

The change from the "ordinary" definition of "good faith" in UCC 1-201(19) to that of a "heightened" definition in R9-102(a)(43) may be more important here than anywhere else in the revised Article 9. Recent cases have dealt with the differences between "at will" clauses and "happening of a specific event" clauses. We can expect that trend to continue, but perhaps with a new "good faith" twist.

Forty-four states have repealed Article 6-Bulk Transfers. Remember also that at least 39 states have adopted the Uniform Fraudulent Transfers Act (UFTA). The adoption of UFTA and the repeal of Article 6 often went together.

*Mixed collateral

Former UCC 9-501(4) dealt with situations when both real property and personal property were combined into one collateral package. The Illinois cases usually involved land trusts.

R9-601 through 9-604 covers much the same ground, but R9-604 specifically covers "real estate and fixtures". The key provision is subsection (a), which reads:

If a security agreement covers both personal and real property, a secured party may proceed: (a) under this part as to the personal property without prejudicing any rights with respect to the real property; or (2) as to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this part do not apply.

Subsections (b) and (c) apply to enforcement and removal problems involving fixtures, while subsection (d) speaks to "injury caused by removal." This presumably applies with particular force to removal of fixtures. The comments are brief, but extremely important. It seems clear that R9-604 revises former UCC 9-501(4) and former 9-313(8) and that the contents of the section are not entirely new.

Strict foreclosure after repossession

The former provision, UCC 9-505, often arose in the context of a modification and partial satisfaction dispute. The new provisions are R9-620 through 9-622, which “favor” strict foreclosure, but require that notice of the strict foreclosure be sent to all who have an “interest in the collateral”, presumably including sureties. Moreover, a partial satisfaction in a consumer transaction is no longer allowed. There is no requirement that the secured party actually possess the collateral before effecting a strict foreclosure. The comments are detailed and important.

*Debtor’s right of redemption

The former provision was UCC 9-506 and reflected the long-held concerns of equity courts. R9-623 is the new provision. Its Comment 2 indicates that the right is now extended to “holders of nonconsensual liens”; does this mean holders of landlord’s liens, etc.? R9-624 indicates that debtors in non-consumer goods cases can waive redemption rights only after default, but remains silent on consumer goods cases.

Resale of the collateral

The former provision was UCC 9-504. Under revised Article 9, there is a model notification form in R9-613 and 9-614. Like the model financing statement, these may now become universally used. Notice that R9-612(b) contains a “safe harbor” of ten days notice in non-consumer cases, although there is no mention of a “safe harbor” for consumer transactions cases. R9-611 and its Comment 6 indicate much more detail on what is required for a resale.

Sanctions

The former provision was UCC 9-507, which R9-625 and R9-626 replace. The most important change is a stipulation that in non-consumer goods cases, the “rebuttable presumption rule”, which has been in effect in most states for many years, will apply. In effect, this eliminates any “absolute bar” of the secured party’s remedies.

R9-626(b) and its Comments 3 and 4 suggest that courts are free to impose the “rebuttable presumption” or perhaps any other rule in consumer goods cases. Would an absolute bar rule for consumer goods cases, at least where the secured party’s misconduct is egregious, be appropriate?

Priorities

The rules remain pretty much the same, but:

*Appendix II contains a Model Section 9-324A, an optional provision, which addresses the issues involving farms currently dealt with in UCC 9-312(2).

