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SFA BILL ANALYSIS

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House Bill 5228 (Substitute H-1 as passed by the House)
House Bills 5402 through 5417 (as passed by the House)
House Bill 5758 (as passed by the House)
Sponsor: Representative Andrew Richner (House Bills 5228 & 5758)
Representative Jim Howell (House Bill 5402)
Representative Charles LaSata (House Bill 5403)
Representative Mike Bishop (House Bill 5404)
Representative Jack Minore (House Bill 5405)
Representative Joanne Voorhees (House Bill 5406)
Representative Bruce Patterson (House Bill 5407)
Representative Michael Switalski (House Bill 5408)
Representative Marc Shulman (House Bill 5409)
Representative Alan Sanborn (House Bill 5410)
Representative Jennifer Faunce (House Bill 5411)
Representative Janet Kukuk (House Bill 5412)
Representative Doug Hart (House Bill 5413)
Representative James Koetje (House Bill 5414)
Representative Gloria Schermesser (House Bill 5415)
Representative Laura Baird (House Bill 5416)
Representative Gerald Law (House Bill 5417)
House Committee: Family and Civil Law (except House Bill 5758)
Criminal Law and Corrections (House Bill 5758)
Senate Committee: Financial Services

Date Completed: 11-9-00

CONTENT

House Bill 5228 (H-1) would amend Article 9 (Secured Transactions) of the Uniform Commercial Code (UCC) to enact the revisions to Article 9 proposed by the National Conference of Commissioners on Uniform State Laws (NCCUSL). According to the NCCUSL, the principal changes in Article 9 do the following:

-- Expand the type of property in which a creditor can take a security interest (including promissory notes, payment intangibles, and health care insurance receivables), and the kinds of transactions that come under Article 9 (including agricultural liens).
-- Provide that filing a financing statement will perfect a security interest even if there is another method of perfection.
-- For the purpose of determining which state's laws apply to interstate secured transactions, choose the state that is the location of the debtor; and, for a debtor that is created by registration in a state, specify that the debtor's location is the state where the entity was created.
-- Distinguish between transactions in which the debtor is a consumer and other transactions, and handle enforcement of a security interest differently in consumer transactions.
-- Include new rules dealing with secondary obligors (guarantors), special rules for some of the new types of property subject to security interests, and new rules for the interests of subordinate creditors.
-- Require centralized filing (one place in the state in which financing statements are filed); and provide that the filing office is not responsible for the accuracy of information on the statements.

The bill also would amend several other sections of the UCC to bring them into conformity with the proposed changes to Article 9.

House Bills 5402 through 5417 and 5758 would amend various statutes that cite sections of the UCC, to bring those citations into conformity with the proposed changes to Article 9. House Bills 5402 through 5417 would amend, respectively, the Vietnam Veteran Era Bonus Act; the Revenue Bond Act; the Uniform Federal Lien Registration Act; the State Tax Lien Registration Act; the Michigan Vehicle Code; Public Act 387 of 1978 (which provides for

State loans to certain motor carriers); the Grain Dealers Act; the Higher Education Facilities Authority Act; Public Act 289 of 1976 (which involves the financing of student loan programs); the Farm and Utility Equipment Act; the Business Corporation Act; the Nonprofit Corporation Act; the Savings Bank Act; the Savings and Loan Act; the Motor Vehicle Sales Finance Act; and the Uniform Fraudulent Transfer Act. House Bill 5758 would amend the Code of Criminal Procedure.

House Bill 5228 (H-1) would take effect on July 1, 2001. House Bills 5404, 5405, 5407, 5408, 5414, 1516, and 5417 also would take effect on that date and are tie-barred to House Bill 5228. House Bill 5758 is tie-barred to House Bill 5228, as well.

A more detailed description of House Bill 5228 (H-1) follows. (The summary below refers to the version proposed by the NCCUSL as "Revised Article 9".)

Overview of Article 9

Article 9 contains rules that govern any transaction (other than a finance lease) that involves the granting of credit coupled with the creditor's interest in personal property belonging to the debtor. If the debtor defaults, the creditor may repossess and sell the property (called "collateral") to satisfy the debt. The creditor's interest is called a "security interest" and the creditor is a "secured party".

When a security interest is created, it must "attach" in order to be effective between the creditor and the debtor. Attachment usually takes place when the parties' agreement provides for attachment to occur. In addition, the security interest must be "perfected" in order for the creditor to have "priority" in relation to other creditors of the debtor who have an interest in the collateral. Perfection usually occurs when a "financing statement" is filed with the State. As a rule, the first creditor to file has first rights to the collateral. Every secured creditor has priority over any unsecured creditor.

Scope of Article

Currently, Article 9 applies to any transaction that is intended to create a security interest in personal property or fixtures, including goods, documents, instruments, general intangibles, chattel paper, or accounts, except as otherwise excluded; to any sale of accounts; and to security interests created by contract.
Revised Article 9 applies to all of the following:

-- A transaction that creates a security interest in personal property or fixtures by contract.
-- An agricultural lien.
-- A sale of accounts, chattel paper, payment intangibles, or promissory notes.
-- A consignment.
-- A security interest in an obligation secured by a non-Article 9 transaction.
-- An assignment of health care insurance receivables by or to a health care provider.
-- An assignment of a commercial tort claim.
-- An obligation that supports payment or performance of collateral.
-- Property that secures a right to payment or performance that is subject to an Article 9 security interest.

Currently, Article 9 does not apply to a transfer of interest in a deposit account, except as provided with respect to proceeds and priorities in proceeds. Revised Article 9 excludes the assignment of a deposit account in a consumer transaction (thereby allowing deposit accounts to be used as original collateral in nonconsumer transactions). In both consumer and nonconsumer transactions, the revised article's rules apply to deposit accounts as proceeds and with respect to priorities in proceeds. (A "deposit account" is an account, such as a savings account, maintained with a bank. "Proceeds" means whatever is acquired when collateral is sold, leased, licensed, exchanged, or otherwise disposed of; whatever is collected on, or distributed on account of, collateral; or rights arising out of collateral.)

Revised Article 9 also narrows the current exclusion of transfers by states and their governmental units. The revised article excludes only transfers covered by another statute (other than one generally applicable to security interests) to the extent that the statute expressly governs the creation, perfection, priority, or enforcement of security interests. In addition, Revised Article 9 narrows the exclusion of security interests subject to a United States statute, by making an exception only when the statute preempts Article 9.

Revised Article 9 defines terms used in these provisions as follows.

"Account" means a right to payment of a monetary obligation, whether or not earned by performance, for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, for services rendered or to be rendered, for an insurance policy issued or to be issued, for a secondary obligation incurred or to be incurred, for energy provided or to be provided, for the use or hire of a vessel under a charter or other contract, arising out of the use of a credit or charge card or information contained on or for use with the card, or as winnings in a government-operated or -sponsored lottery or other game of chance. The term includes health care insurance receivables. It does not include rights

to payment evidenced by chattel paper or an instrument, commercial tort claims, deposit accounts, investment property, letter-of-credit rights or letters of credit, or rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

"Agricultural lien" means an interest, other than a security interest, in farm products that 1) secures payment or performance of an obligation for goods or services furnished in connection with the debtor's farming operation, or rent on real property leased by a debtor in connection with its farming operation; 2) is created by statute in favor of a person that furnished the goods or services in the ordinary course of its business or leased the real property; and 3) does not depend on the person's possession of the personal property.

"Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in them.

"Commercial tort claim" means a claim arising in tort with respect to which 1) the claimant is an organization, or 2) the claimant is an individual and the claim arose in the course of his or her business or profession and does not include damages arising out of personal injury to or death of an individual.

"General intangibles" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes software and payment intangibles (which are general intangibles under which the account debtor's principal obligation is monetary).

"Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include investment property, letters of credit, or writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use of the card.

"Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

Duties of Secured Party

Part 2 of Revised Article 9 provides for new duties of secured parties. It imposes on a secured party having control of a deposit account, investment property, letter-of-credit right, or electronic chattel paper, the duty to relinquish control of collateral when there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value. Under the same conditions, if an account debtor has received notification of an assignment to a secured party, the secured party must send the account debtor an authenticated record releasing the debtor from any further obligation. ("Account debtor" means a person obligated on an account, chattel paper, or general intangible; it does not include a person obligated to pay a negotiable instrument.)

Part 2 also contains a procedure under which a debtor may obtain from a secured party information about the secured obligation and the collateral in which the secured party may claim a security interest. As a rule, a secured party must comply with a request for information within 14 days after receiving the request.

In addition, Part 6 of the revised article (described below) includes some additional duties of secured parties in connection with default and enforcement (such as the duty to explain the calculation of a deficiency or surplus in a consumer goods transaction).

Choice of Law

Part 3 (Subpart 1) of Revised Article 9 contains choice-of-law rules governing perfection (where to file), the effect of perfection or nonperfection, and priority.

For most collateral, Part 3 changes the choice-of-law rule governing perfection to the law of the jurisdiction where the debtor is located. (Under the current article, the jurisdiction of the debtor's location governs only perfection and priority of a security interest in accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property.)

Under the current and revised articles, the location of the debtor is the debtor's place of business (or the chief executive office, if the debtor has more than one place of business). Part 3 makes three exceptions to this rule. A "registered organization", such as a corporation or limited liability company, is

located in the state under whose law the debtor is organized. An individual debtor is located at his or her principal residence. Special rules determine the location of the United States and registered organizations organized under the law of the United States. If, under these rules, a debtor is located in a jurisdiction whose law does not require public notice as a condition of perfecting a nonpossessory security interest, the debtor is considered to be located in the District of Columbia.

For tangible collateral, such as goods and instruments, Part 3 provides that the law applicable to priority and the effect of perfection or nonperfection is law of the jurisdiction where the collateral is located. For intangible collateral, such as accounts, the applicable law for priority is that of the jurisdiction where the debtor is located.

In regard to possessory security interests and agricultural liens, the law of the jurisdiction where the collateral is located governs perfection, the effect of perfection or nonperfection, and priority.

Part 3 also revises the treatment of choice-of-law matters for goods covered by certificates of title (and applies not only to certificate-of-title statutes under which perfection occurs when the security interest is noted on the certificate, but also to statutes that provide for notation but under which perfection is achieved by another method). As a rule, perfection and priority are governed by the law of the jurisdiction under whose certificate of title the goods are covered, from the time the goods become covered and until they cease to be covered by the certificate of title.

In addition, Part 3 provides special choice-of-law rules for deposit accounts, investment property, and letter-of-credit rights, and addresses perfection following a change in applicable law. In general, a security interest perfected under the law of one jurisdiction remains perfected for a fixed period of time (four months or one year, depending on the circumstances), even though the jurisdiction whose law governs perfection changes; the fixed period is cut short, however, if perfection would have ceased under the original law.

Perfection

With certain exceptions, Part 3 (Subpart 2) of Revised Article 9 provides that a security interest in a deposit account or a letter-of-credit right may be perfected only by the secured party's acquiring control of the account or right. A secured party has control of a deposit account when, with the debtor's consent, the secured party obtains the depository bank's agreement to act on that party's instructions or when the secured party is itself the depository bank. Control of a letter-of-credit right occurs when the issuer or nominated person consents to an assignment of proceeds of the letter of credit.

In addition, a security interest in electronic chattel paper is perfected by control. ("Electronic chattel paper" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.) A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned as described in the article.

Part 3 includes instruments among the types of collateral in which a security interest may be perfected by the filing of a financing statement. Agricultural liens and commercial tort claims also are perfected by filing.

Part 3 expands the types of sales of receivables (including health care insurance receivables) that are subject to the article's filing system. The sale of payment intangibles is exempt from the filing requirements. The sale of payment intangibles and the sale of promissory notes are perfected when they attach.

As currently provided, a security interest in goods, instruments, negotiable documents, money, or tangible chattel paper may be perfected by the secured party's taking possession of the collateral. Under Part 3, if the collateral is in the possession of a third party, the security interest is perfected when that party acknowledges in an authenticated record that it holds for the secured party's benefit. If a secured party already is in possession of collateral, the security interest remains perfected by possession if the secured party delivers the collateral to a third party with instructions to hold it for, or redeliver it to, the secured party. Part 3 also specifies the limited circumstances under which a security interest in goods covered by a certificate of title may be perfected by the secured party's taking possession.

Part 3 specifies the types of security instruments that are automatically perfected (perfected by attachment without public notice). These include a purchase money security interest in consumer goods, a sale of a payment intangible or promissory note, and a

security interest created by the assignment of a health care insurance receivable to the provider of the health care goods or services.

In addition, Part 3 provides that a perfected security interest in collateral supported by a "supporting obligation" (such as secondary obligation that supports the payment or performance of an account) also is a perfected security interest in the supporting obligation, and a perfected security interest in an obligation secured by a security interest or lien on property (such as a real property mortgage) also is a perfected security interest in the security interest or lien.

Priority

Part 3 (Subpart 3) of Revised Article 9 establishes priority rules for competing purchase money security interests (PMSIs) in the same collateral, and makes changes regarding nonconsumer PMSIs. (A "purchase money security interest" is an obligation incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.) In a nonconsumer goods transaction, the revised article adopts a "dual status rule" that allows a security interest in collateral (to some extent) to be both a PMSI and a non-PMSI. If a security interest is in inventory that is or was purchase money collateral, the security interest also is a PSMI to the extent that it secures a purchase money obligation incurred with respect to other inventory in which the secured party holds or held a PMSI. ("Purchase money collateral" means goods or software that secures a purchase money obligation incurred with respect to that collateral.) The revised article treats consignments as PMSIs in inventory.

As a rule, Part 3 gives a perfected interest in inventory or livestock priority over a conflicting security interest in the same inventory or livestock. The revised article also provides for a special non-Article 9 priority rule for agricultural liens, which can override the general rule that gives priority to the first party to file or perfect: A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

Part 3 contains a new priority rule for a software PMSI. ("Software" is defined as a computer program and any supporting information provided in connection with a transaction relating to the program; it does not include a computer program that is included in the definition of "goods".) Generally, a perfected PMSI in software has priority over a conflicting security interest in the same collateral. Also, under some circumstances, a security interest in goods may be accompanied by a PMSI in software used in the goods.

Part 3 contains rules governing priority among conflicting security interests in investment property. A security interest held by a secured party having control of the investment property has priority over a security interest held by a secured party that does not have control. If each secured party has control, the conflicting interests rank according to priority in time of specified events (generally, the time that control is obtained). (Currently, conflicting security interests of secured parties who have control usually rank equally.)

Similarly, if a secured party has control of a deposit account or letter-of-credit right, the security interest has priority over a conflicting security interest held by a party without control. Security interests perfected by control rank according to priority in time of obtaining control. In the case of a deposit account, however, a depository bank's security interest is senior to another secured party's security interest. Also, a depository bank's right of set-off is senior to a security interest held by another secured party, unless the other party becomes the bank's customer with respect to the deposit account.

As currently provided, a purchaser of chattel paper who gives new value and takes possession of the collateral (or obtains control of it, in the case of electronic chattel paper) has priority over a conflicting security interest claimed merely as proceeds. Under Part 3, however, the purchaser must act in good faith and in the ordinary course of business, and the paper cannot indicate that it has been assigned to someone other than the purchaser. Part 3 also gives priority to purchasers of instruments who take possession in good faith and without knowledge that the purchase violates the rights of a competing secured party. ("Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.)

Under the current and revised articles, a buyer in ordinary course of business takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence. The current and revised articles also make an exception to this provision for a buyer of farm products from a person engaged in farming operations. House Bill 5228 (H-1), however, would retain current provisions in Article 9 that govern priority in such a case. These provisions are not contained in the version of Revised Article 9 proposed by the NCCUSL.

Proceeds

Currently, the term "proceeds" includes whatever is

received upon the sale, exchange, collection or other disposition of collateral, or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds.

Revised Article 9 defines "proceeds" as one or more of the following:

-- Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral.
-- Whatever is collected on, or distributed on account of, collateral.
-- Rights arising out of collateral.
-- To the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral.
-- To the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

Third-Party Rights

A new Part 4 of Revised Article 9 contains several provisions relating to the relationships between third parties and the parties in secured transactions. In particular, Part 4 addresses the rights and duties of account debtors and other persons obligated on collateral who are not, themselves, parties to a secured transaction.

Part 4 specifies that whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than Article 9, with certain exceptions. Similarly to the current article, Part 4 provides that an agreement between the debtor and the secured party that prohibits the transfer of the debtor's rights in collateral, or makes the transfer a default, does not prevent the transfer from taking effect.

Under the current article, the mere existence of a security interest or authority given to the debtor to dispose of or use collateral does not impose contract or tort liability upon the secured party for the debtor's acts or omissions. Part 4 also refers to the existence of an agricultural lien.

Like the current article, Part 4 generally validates an agreement between an account debtor and an assignor that the account debtor will not assert against an assignee claims and defenses that it may have against the assignor. Under Part 4, this provision applies to all account debtors, while the current provision applies to a buyer or lessee of goods. Also, Part 4 provides that, in a consumer transaction, if a record of the account debtor's obligation is required to contain a statement that the rights of an assignee are subject to the claims or defenses that the account debtor could assert against the original obligee, and the record does not contain that statement, the record has the same effect as if it did include the statement and an assignee of the record takes subject to the consumer account debtor's claims and defenses.

As currently provided, an assignee generally takes an assignment subject to the terms of the agreement between the account debtor and the assignor, and to other claims and defenses of an account debtor against the assignor that accrue before the account debtor receives notice of the assignment. Under Part 4, the claim of an account debtor may be asserted against an assignee only to reduce the amount the debtor owes. Part 4 also specifies that these provisions are subject to a law other than Article 9 that establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes. In a consumer transaction, if a record of the account debtor's obligation is required to contain a statement that the debtor's recovery against an assignee may not exceed amounts paid by the debtor under the record, and the record does not contain that statement, the consumer account debtor has the same right to recovery from an assignee of the record as he or she would have had if the record contained the required notice.

Under Part 4, good faith modifications of assigned contracts are binding against an assignee to the extent that 1) the right to payment has not been fully earned, or 2) the right to payment has been earned and notification of the assignment has not been given to the account debtor. (Current law does not permit modification of fully performed contracts, regardless of notification.) Part 4 specifies that these provisions are subject to a law other than Article 9 that establishes a different rule for an account debtor who is an individual and incurred the obligation primarily for personal, family, or household purposes.

Part 4 retains the general rule concerning an account debtor's right to pay the assignor until the debtor receives appropriate notification of the assignment. Once the account debtor receives the notification, the debtor cannot discharge its obligation by paying the assignor. Payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation. Under Part 4, an effective notification must be authenticated. Also, at the option of the account debtor, notification is ineffective if it notifies the debtor to make less than the full amount of any installment or other periodic

payment to the assignee. In general, a term in an agreement prohibiting or restricting an assignment of an account, chattel paper, payment intangible, or promissory note, is ineffective, and legal restrictions on the assignment of an account or chattel paper are ineffective.
As currently provided in Article 2A (Leases), Part 4 specifies that a term in a lease agreement that prohibits or restricts the creation of a lease agreement is ineffective, subject to certain exceptions.

Part 4 contains new provisions that make ineffective any attempt to restrict the assignment of a general intangible, health care insurance receivable, or promissory note, if the restriction appears in the terms of a promissory note or the agreement between an account debtor or in a rule of law. If a restriction is ineffective because of these provisions, but would be effective under a law other than Article 9, the account debtor's or obligated person's rights and obligations are unaffected.

Part 4 also limits the effectiveness of a term in a letter of credit or a rule of law, statute, regulation, custom, or practice, that restricts the creation, attachment, or perfection of a security interest in a letter-of-credit right. If such a term in a letter of credit would be effective under a law other than Article 9 or an applicable custom or practice, Part 4 limits the obligations of an issuer or nominated person.

Filing

Under Part 5 of Revised Article 9, the parties may file and otherwise communicate with a filing office by means of records communicated and stored in a media other than paper. (The revised article defines "record" as information that is inscribed on a tangible medium or stored in an electronic or other medium and is retrievable in perceivable form.)

Part 5 addresses whose authorization is necessary for a person to file a record with a filing office (and makes the identity of the person filing immaterial). The debtor's authorization is required for filing an initial financing statement, an amendment that adds collateral covered by a financing statement, or an amendment that adds a debtor to a financing statement. The authorization of the secured party of record is required for the filing of other amendments. The debtor, however, may file a termination statement indicating that it has been filed by the debtor, if the secured party has failed to file a termination statement that is required because there is no outstanding secured obligation or commitment to give value. Unlike the current article, Part 5 does not require the debtor's signature on a financing statement, although the debtor's authorization must be in an authenticated record. A filed record is effective only to the extent that it was filed by an authorized person. ("Authenticate" means 1) to sign, or 2) to execute or otherwise adopt a symbol, or encrypt or similarly process a record, with the present intent of the authenticating person to identify the record and adopt or accept a record.)

Under Part 5, a financing statement is sufficient only if it provides the name of the debtor, provides the name of the secured party or a representative of the secured party, and indicates the collateral covered. Part 5 addresses the sufficiency of a name on a financing statement, and provides that a financing statement sufficiently indicates collateral if it describes the collateral as required in the article, or indicates that it covers "all assets or all personal property". Part 5 contains standard forms for the UCC Financing Statement, and the UCC Financing Statement Amendment.

In addition to allowing a debtor to file a termination statement, as described above, Part 5 allows a debtor to file a correction statement if the debtor believes that a record is inaccurate or was wrongfully filed. The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record.

Part 5 also contains several provisions governing filing office operations. It prohibits a filing office from refusing to accept a record for filing, except for one of the reasons specified (e.g., the record is not communicated by a method or medium authorized by the office; the filing fee is not paid; or the record does not give a name and mailing address for the secured party). A filing office is required to index an initial financing statement according to the debtor's name, link all subsequent related filings to the initial financing statement and all related records, and be able to associate and retrieve with one another an initial financing statement and each filed record relating to it.

A filing office may not delete a financing statement or related records sooner than one year after lapse, and then only if a continuation statement has not been filed. An office also must maintain a record of the information provided in a filed financing statement for at least one year after the statement has lapsed with respect to all secured parties of record. As currently provided, the effectiveness of a financing statement usually will lapse five years after the filing date, unless a continuation statement is filed within six months before the lapse. Under Part 5, however, an initial financing statement filed in connection with a "public-finance transaction" or a "manufactured-home transaction" is effective for 30 years. ("Public-finance transaction" means a secured transaction in connection with which: 1) debt securities are issued; 2) all or a portion of the securities issued have an initial stated maturity of at least 20 years; and 3) the debtor, obligor, secured party, account debtor or

other person obligated on collateral, or assignor or assignee of a secured obligation or of a security interest is a state or governmental unit of a state.)

Part 5 also mandates certain performance standards for filing offices. As a rule, an office must perform its required functions within two business days after receiving a record or a request.

Part 5 requires the Secretary of State to adopt and publish rules to implement Revised Article 9. In doing so, the Secretary of State must do all of the following:

-- Consult with filing offices in other jurisdictions that substantially enact Part 5.
-- Consult the most recent version of the model rules promulgated by the International Association of Corporate Administrators.
-- Take into consideration the rules and practices of, and the technology used by, filing offices of other jurisdictions that substantially enact Part 5.

Part 5 also requires the Secretary of State to report annually to the Governor and the Legislature on the operation of the filing office.

Filing Fees

Currently, Article 9 prescribes the following fees for filing an original financing statement, a continuation statement, an amendment of a financing statement, or an assignment:

-- $3 for a filing with the Secretary of State or a register of deeds, if the statement contains the information required to be included and is in the standard form. Otherwise, the fee is $6.
-- For a filing with the register of deeds, if the document indicates that it is to be recorded in the real estate records, $5 for the first page and $2 for each additional page.
-- $3 for each additional name, if more than one name must be indexed. If a secured party wants to show a trade name for a person, there is an extra indexing fee of $3.

For the following, the current fee is $3 if the document is in the standard form, or $6 if it is not:

-- Filing a statement of release, plus an additional $3 for each name over one against which the statement must be indexed.
-- Filing or furnishing filing data about a separate statement of assignment.
-- Issuing a certificate showing whether a financing statement about a particular debtor or a statement of assignment is on file.

The Secretary of State also must furnish a copy of a filed financing statement or statement of assignment for $1 per page, and must charge an additional fee of $25 if a person requests that the search process be expedited.

The current article also provides that the fees collected by the Secretary of State under the Code must be deposited in the General Fund and are appropriated to the Department of State to cover the Secretary of State's expenses in administering the Code. Any unspent and unencumbered balance remaining at the close of each year must revert to the General Fund.

Part 5 of Revised Article 9 prescribes fee requirements for filing, indexing, and responding to requests for information, but does not set fee amounts. Under House Bill 5228 (H-1), the fee for filing and indexing a record under Part 5 would be $10, plus one or more of the following, if applicable:

-- An additional fee of $7, if the record were a financing statement or a financing statement amendment in a form other than that contained in the revised article.
-- An additional fee of $12 if the record contained over 100 pages.
-- An additional fee of $10 for each name above two that the filing officer had to index.

A filing office would have to charge a person a fee for responding to a request for a search of the records filed with the office concerning a debtor, including issuance of a certificate describing each presently effective record filed concerning the debtor if requested. The fee would be $6, plus one or more of the following, if applicable:

-- An additional fee of $6 if the person requested a certificate and the search disclosed more than 100 presently effective records filed concerning the debtor.
-- An additional fee of $25 if the person requested that the regular search process be expedited.
-- An additional fee of $2 per page if the person requested copies of the presently effective records disclosed by the search.
-- An additional fee of $6 if the filing office were the Secretary of State and the person requested the Secretary of State to include an impression of the official seal of the Secretary of State on the certificate.

Part 5 states that these provisions do not require a fee with respect to a record of a mortgage that is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut. The recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply,

however.

Default and Enforcement

Part 6 of Revised Article 9 identifies persons who have rights and persons to whom a secured party owes specified duties, including the rights and duties that belong to the debtor and to any obligor. ("Debtor" means any person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; a seller of accounts, chattel paper, payment intangibles, or promissory notes; or a consignee. "Obligor" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, owes payment or other performance of the obligation, has provided property other than the collateral to secure payment or other performance, or is otherwise accountable in whole or in part for payment or other performance.) A secured party, however, is relieved from any duty or liability to any person unless the secured party knows that the person is a debtor or obligor.

Part 6 describes rules that a debtor or obligor may not waive or vary. These include rules that allow a secured party to use and operate collateral as agreed by the parties (except in the case of consumer goods); impose a duty to collect collateral, and apply noncash proceeds, in a commercially reasonable manner; and the right to a special method of calculating a surplus or deficiency; the right to limitations on the effectiveness of certain waivers; and the right to hold a secured party liable for failure to comply with the article. By an agreement entered into and authenticated after default, a debtor or secondary obligor may waive the right to notification of disposition of collateral; a debtor may waive the right to require disposition of collateral; and (except in a consumer-goods transaction) a debtor or secondary obligor may waive the right to redeem collateral.

Part 6 explains the rights of a secured party who seeks to collect or enforce collateral after default; and sets forth the enforcement rights of a depository bank holding a security interest in a deposit account maintained with the bank.

In general, after default, a secured party may 1) take possession of the collateral, and/or 2) with removal, render equipment unusable and dispose of collateral on a debtor's premises. A secured party may take these actions either pursuant to judicial process or, if the secured party proceeds without breach of the peace, without judicial process. A secured party also may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing. A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like that, by operation of law, accompany a voluntary disposition of property of the kind subject to the contract. A secured party may disclaim or modify these warranties, however.

A secured party that disposes of collateral is required to give notice of the disposition to the debtor, any secondary obligor, and (if the collateral is not consumer goods) other secured parties or lienholders who have filed financing statements against the debtor covering the collateral. This notice is not required, however, if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

In addition, Part 6 addresses the application of proceeds of disposition. As a rule, a secured party must account to and pay a debtor for any surplus, and an obligor is liable for any deficiency. Part 6 also addresses the effects of a disposition by a secured party, including the rights of transferees of the collateral.

Under Part 6, a secondary obligor obtains the rights and assumes the duties of a secured party if the secondary obligor receives an assignment of a secured obligation, agrees to assume the secured party's rights and duties upon a transfer of collateral to the secondary obligor, and becomes subrogated to the rights of the secured party with respect to the collateral. Unlike the current article, Part 6 states that an assignment, transfer, or subrogation relieves the secured party of further duties under Revised Article 9 (although it is not considered a disposition of collateral).

In a new provision, Part 6 specifies that a transfer of the record or legal title to collateral to a secured party is not of itself a disposition of collateral under Revised Article 9 and does not itself relieve the secured party of its duties under the article.

The current article permits a secured party to accept collateral only in full satisfaction of an obligation it secures. Part 6 allows a secured party to accept collateral in either full or partial satisfaction of the obligation, if the debtor consents to the acceptance and the secured party does not receive a notice of objection from any other person holding a subordinate interest in the collateral. (Provisions specific to consumer transactions are described below.)

A secured party's acceptance of collateral discharges the obligation to the extent consented to by the debtor; transfers to the secured party all of the debtor's rights in the collateral; discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security

interest or other subordinate lien; and terminates any other subordinate interest. Part 6 specifies that a subordinate interest is discharged or terminated even if the secured party fails to comply with the revised article.

In an action arising from a transaction in which the amount of a deficiency or surplus is in issue (except in regard to a consumer transaction), Part 6 creates a rebuttable presumption by stating that a secured party need not prove compliance with provisions of this part relating to collection, enforcement, disposition, or acceptance, unless the debtor or a secondary obligor places the secured party's compliance in issue. If the secured party's compliance is placed in issue, and the secured party fails to prove compliance, the amount of a deficiency must be calculated as described in Part 6. The revised article states that the limitation of these provisions to transactions other than consumer transactions "is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches."

In addition, Part 6 provides a method of calculating a deficiency if the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought".

Remedies for Noncompliance

Under the current article, if it is established that the secured party is not proceeding in accordance with the provisions of the part governing default and enforcement, disposition may be ordered or restrained on appropriate terms and conditions. If disposition has occurred, the debtor or any person entitled to notification, or whose security interest has been made known to the secured party before the disposition, has a right to recover from the secured party any loss caused by a failure to comply. Part 6 of Revised Article 9 retains these provisions, and specifies that loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing. Part 6 also states that a person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral, may recover damages for the person's loss.

Currently, if the collateral is consumer goods, the debtor may recover at least the credit service charge plus 10% of the principal amount of the debt or the time price differential plus 10% of the cash price. Part 6 retains this provision, and extends it to a secondary obligor. Part 6 specifies that a secured party is not liable under this provision more than once with respect to any one secured transaction, and is not liable to any person under this provision for its failure to give an explanation of the calculation of a deficiency or surplus.

Part 6 permits a debtor whose deficiency is eliminated to recover damages for the loss of surplus, except in certain circumstances.

In addition to the damages recoverable under the preceding provisions, Part 6 allows the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, to recover $500 in each case from a person for any of the following:

-- Failure by a secured party to relinquish control of, or to free up, collateral when there is no outstanding secured obligation or commitment to give value in the future.
-- Filing a record that the person is not entitled to file.
-- Failure to cause the secured party of record to file or send a termination statement as required.
-- Failure to provide an explanation of the calculation of a surplus or deficiency in a consumer-goods transaction, if the failure is a part of a pattern, or consistent with a practice, of noncompliance.
-- Failure by a secured party to send to a consumer obligor a record waiving the secured party's right to a deficiency.

A debtor or consumer obligor also may recover, in addition to damages, $500 in each case from a person who, without reasonable cause, fails to comply with a request for an accounting or a request regarding a list of collateral or a statement of account. If a secured party fails to comply with such a request, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person who is reasonably misled by the failure.

Part 6 also provides that a secured party is not liable to a person for failure to comply with Revised Article 9 unless the secured party knows that the person is a debtor or obligor, knows the person's identity, and knows how to communicate with the person; and the secured party is not liable to a secured party or lienholder that has filed a financing statement against the person. The secured party's failure to comply does not affect the liability of the person for a deficiency.

Also, a secured party is not liable because of its status as secured party to either of the following:

-- A person that is a debtor or obligor, unless the secured party knows that the person is a debtor or obligor, the identity of the person, and how to communicate with the person.
-- A secured party or lienholder that has filed a financing statement against a person, unless the secured party knows that the person is a debtor and knows the person's identity.

Further, a secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on either or both of the following:

-- A debtor's representation concerning the purpose for which collateral was to be used, acquired, or held.
-- An obligor's representation concerning the purpose for which a secured obligation was incurred.

Consumer Goods & Transactions

Revised Article 9 contains various provisions (some of which are mentioned above) that apply to, or exclude, consumer goods, consumer-goods transactions, and consumer transactions. ("Consumer goods" means goods that are used or bought for use primarily for personal, family, or household purposes. "Consumer-goods transaction" means a consumer transaction in which an individual incurs an obligation primarily for personal, family, or household purposes and a security interest in consumer goods secures the transaction. "Consumer transaction" means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes, a security interest secures the transaction, and the collateral is held or acquired primarily for personal, family, or household purposes.)

Consumer-goods transactions are not subject to provisions that 1) deal with the allocation of payments for determining the extent to which a security interest is a PMSI; 2) provide that purchase-money status is not affected by cross-collateralization, refinancing, or restructuring; and 3) specify that a secured party has the burden of establishing the extent of purchase-money status. The revised article states that the limitation of these provisions to transactions other than consumer-goods transactions "is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches."

Revised Article 9 provides that a description only by type of collateral defined in the UCC is an insufficient description, in a consumer transaction, of consumer goods, a security entitlement, a securities account, or a commodity account.

In regard to the requirement that a secured party send notification of disposition, Part 6 states that a notification sent after default and 10 days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition. This provision, however, does not apply to a consumer transaction. In a consumer transaction, Part 6 describes the required contents of a notification of disposition, and contains a form that will provide sufficient information.

In a consumer transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency, the secured party is required to send the debtor or consumer obligor an explanation of how the secured party calculated the surplus or deficiency.

Under provisions in Part 6 allowing a secured party to accept collateral in satisfaction of the obligation, if the collateral is consumer goods, it must not be in the debtor's possession when the debtor consents to acceptance. Also, in a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation.

As currently provided, if 60% of the principal amount of an obligation has been paid in the case of an obligation secured by a security interest in consumer goods (or if 60% of the cash price has been paid in the case of a PMSI in consumer goods), the secured party is required to dispose of the collateral after repossessing it, unless the debtor waives this requirement.

Transition Provisions

Part 7 of Revised Article 9 addresses the transition from the current article to the revised article. Except as otherwise provided in Part 7, Revised Article 9 applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before the amendatory act takes effect. The amendments do not affect an action, case, or proceeding commenced before the amendatory act takes effect.

Part 7 addresses security interests that are perfected under the current article or other applicable law immediately before the amendatory act takes effect. If the security interest would be a perfected security interest under Revised Article 9, no further action is required for the security interest to be perfected. If the security interest does not satisfy the revised article's requirements for enforceability or perfection, it generally will be perfected for one year after the act's effective date. If the security interest satisfies the requirements for attachment and perfection within that period, it will remain perfected.

If a security interest is enforceable but unperfected (subordinate to the rights of a person who becomes a lien creditor) under the current article or other applicable law immediately before the amendatory act takes effect, it will remain enforceable for one year after the effective date, and thereafter if the appropriate steps for attachment under the revised article are taken before that period expires. The security interest becomes effective on the act's effective date if it satisfies the requirements for perfection under Revised Article 9. If the security interest does not satisfy the requirements for perfection until a later time, it will become perfected at that time.

Part 7 also addresses situations in which action is taken to perfect a security interest under the current article or other applicable law before the amendatory act takes effect, but the security interest does not attach until after that date. Separate rules apply if the action taken is the filing of a financing statement or some other action. Also, if a financing statement was filed in a jurisdiction that is proper under the current article but would be improper under the revised article, the financing statement remains effective until it would become ineffective under the law of the jurisdiction where it was filed, or until June 30, 2006, whichever is earlier. If a continuation statement is filed, it must be filed in the state and office designated by Revised Article 9. Also, the previously filed financing statement and the continuation statement, taken together, must satisfy the revised article's requirements for an initial financing statement concerning the sufficiency of the debtor's and secured party's names and the indication of collateral.

In addition, Part 7 deals with the continued effectiveness of a financing statement that is filed in the proper state and office under the current article but would be filed in the wrong state or office under Revised Article 9. The effectiveness can be continued if an initial financing statement is filed in the office specified by the revised article, if the previous financing statement was filed in an office in another state or in another office in this State.

Part 7 provides that Revised Article 9 will determine the priority of conflicting claims to collateral. When the relative priorities of the claims were established before the amendatory act takes effect, however, the current article governs.

Repealed Sections

The bill would repeal sections of Article 9 that pertain to the following:

-- The rights of an owner of collateral who is not the debtor (Sec. 9112).
-- Security interests arising solely under Article 2 (Sales) or Article 2A (Leases) (Sec. 9113).
-- The priority of a person who delivers goods under a consignment that is not a security interest (Sec. 9114).
-- Security interests in investment property (Sec. 9115 & 9116).
-- Financing statements filed by a consignor or lessor of goods (Sec. 9408a).
-- Bulk sales of documents filed with the Secretary of State (Sec. 9410).

Other Articles

The bill would amend Article 1 (General Provisions) to revise the definitions of "buyer in ordinary course of business", "purchaser", and "security interest".

Amendments to Article 2 and Article 2A would address the interaction between those articles and Article 9.

The bill would add a new section to Article 5 (Letters of Credit) to provide for a security interest in documents presented under a letter of credit in favor of the issuer and a nominated person on the letter of credit.

The bill also would make various conformity amendments to sections of Article 8 (Investment Securities).

MCL 440.1105 et al. (H.B. 5228)
35.1037 (H.B. 5402)
141.114 (H.B. 5403)
211.665 (H.B. 5404)
211.684 (H.B. 5405)
257.58b (H.B. 5406)
257.934 (H.B. 5407)
285.67a (H.B. 5408)
390.931 (H.B. 5409)
390.1355 (H.B. 5410)
445.1459 (H.B. 5411)
450.1471 (H.B. 5412)
450.2471 (H.B. 5413)
487.3501 (H.B. 5414)
491.420 (H.B. 5415)
492.114 (H.B. 5416)
566.38 (H.B. 5417)
777.14 (H.B. 5758)

Legislative Analyst: S. Lowe

FISCAL IMPACT

House Bill 5228 (H-1)

State: The proposed revisions to Article 9 of the Uniform Commercial Code would affect the State primarily through the filing requirements. The bill would designate the Department of State as the central filing office and also increase the uniform filing fee from $3 to $10, with the noncompliance charge increasing from $3 to $7. There also would be an increase in additional charges: $12 for filings over 100 pages and $10 for each name over two that was indexed. Record search fees would increase from $3 to $6. Additional charges of $6 for searches revealing over 100 records and $2 for printing a page, currently $1 per page, also would be imposed. The revenue received by the State from filing fees would increase due to greater levels of filing with the State and higher fees. The net impact is indeterminate since each locality maintains individual filing records and the number of filings that would shift to the State is unknown. In FY 1999-2000, the Department of State collected $2,492,700 in filing fees.

The State also would have to comply with the electronic filing requirements of the bill. The technological enhancements necessary for compliance include computer hardware and software, electronic imaging, automation, and modernization of processes for faster processing. The Department is currently evaluating the cost of implementing these technological changes.

Local: Local governments would experience a loss of filing fee revenue as organizations would be required to file with the State. However, local units would continue to register fixture filings. With the filing fee increased by $7, the loss in revenue from reduced filing overall would be somewhat offset. The net impact is indeterminate since each locality maintains individual filing records.

House Bills 5402-5417, & 5758

The bills would have no fiscal impact on State or local government.

Fiscal Analyst: J. Runnels

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