

THE EAGLE 9[®] NEWSLETTER



The First American Corporation
UCC DIVISION

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UCC EAGLE 9[®] policies insure commercial loan transactions, including

- Mixed-collateral loans
- Asset-based loans
- Mezzanine lending
- Fixtures
- Loan workouts/bankruptcy
- Equipment leasing
- Existing loan portfolios
- Project finance

INTRODUCTION

Welcome again to the Newsletter of the UCC Division of The First American Corporation. Our operating groups continue to grow apace, across market segments. As we have said before, we hope that the Newsletter is of benefit to you in your commercial lending activities, whether as lender or counsel. If you have any suggestions for the Newsletter, please let us know.

Of particular interest is our new Borrower's Status Endorsement that connects the dots in the scope of coverage of our UCC Lender's Policy. We have consistently maintained that, except for a remedies opinion which the TriBar Report considers inappropriate for a lender's counsel to request from borrower's counsel in the first instance because lender's counsel after all drafted the loan and security agreement, our UCC Lender's Policy provides all of the relevant "coverage" typically provided by the opinion of borrower's counsel. If we insure the enforceability and priority of the lender's security interest in the collateral provided by the debtor, we have, by definition, covered the risk that the debtor is not duly organized and validly existing as a, e.g., corporation under the laws of its jurisdiction of organization. The same statement could also be made for most of the substantive paragraphs of a typical opinion of borrower's counsel.

Of greater significance, our standard for liability is strict contractual liability under the UCC Lender's Policy and not some community standard of negligence applicable to counsel providing the opinion. Further, in underwriting our coverage, we conduct due diligence of the records of the debtor similar to the review conducted by counsel in providing the typical legal opinion.

However, the insuring clauses of the UCC Lender's Policy did not specifically set forth the foundational elements to the underwriting of our insuring clauses. In response to requests from lender's counsel, we have prepared what we call the Borrower's Status Endorsement. This endorsement that insures the insured from actual loss and damage by reason of the failure of attachment, perfection or priority of the security interest of the insured resulting from one of the foundational elements being incorrect. The actual language of the endorsement follows:

The Company hereby insures the Insured as of Date of Policy against actual loss or damage sustained or incurred by the Insured by reason of lack of Attachment, Perfection, Priority or enforcement, in accordance with the provisions of the Uniform Commercial Code, of the Insured Security Interest in any portion of the Collateral as a result of any of the following:

1. the failure of the Debtor to be a [corporation/limited liability company/limited partnership] validly existing and in good standing under the laws under the state of [California];
2. the failure of the Debtor to be qualified to do business as a foreign [corporation/limited liability company/limited partnership] in each of the following jurisdictions: _____;
3. the failure of the Debtor to have the [corporation/limited liability company/limited partnership] power and [corporation/limited liability company/limited partnership] authority to enter into the [lien granting document/loan agreement];

**(Oh, no) They've
Changed to Code**
(Tune: Ding Dong the Witch is
Dead, Wizard of Oz)

Oh no they've changed the
Code
Which old Code?
Bankruptcy Code
Oh no they've gone and
changed the Code
Preference is narrower
For payments from the
borrower
If in the ordinary course
Two years the look back now
If fraud may be around
Yes even though
It wasn't your intention

In just 180 days
Lenders must adjust their
ways
Let them know the good old
Code is changed

[lollipop guild]

We represent the CFA, the
CFA, the CFA
And in the name of the C-F-A
We wish they hadn't gone and
changed the Code

[lullaby league]

We represent consumers'
rights, consumers' rights,
consumers' rights
And in the name of
consumers' rights
We wish they hadn't gone and
changed the Code

[mayor]

This is a cause of much
rewriting
And changes in provisions
citing
Let news to all the lawyers
flow
The Code has changed – look
out below

4. the failure of the Debtor to have duly authorized and approved by all requisite [corporation/limited liability company/limited partnership] action on its part the execution and delivery of the [lien granting document/loan agreement] and the grant of the Insured Security Interest contemplated thereby;
5. the failure of the Debtor to obtain any consent to the execution or performance of the [lien granting document/loan agreement] required under the laws of the United States or under the laws of the state of [California]; or
6. the failure of the [lien granting document/loan agreement] to have been duly executed or delivered by a duly authorized officer of the Debtor or not constituting the legal, valid and binding grant of the Insured Security Interest by the Debtor.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, this endorsement neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

The purpose of the endorsement is to provide the lender, in the lower dollar valued transaction that does not justify the borrower engaging counsel or in a higher dollar valued transaction where the borrower refuses to retain counsel, an alternative to relying solely on the representations and warranties of the borrower. We hope this endorsement provides a clearer understanding as to what we believe is covered in the insuring clauses of our UCC Lender's Policy. The endorsement further demonstrates one aspect of the risk management functionality of our UCC Lender's Policy.

We also want to remind everyone of our Search and Filing Section, a full service company providing insured and uninsured UCC searches and filings, as well as litigation, tax, bankruptcy and other data base searches, again on an insured and uninsured basis.

As we all know, among the requirements of an effective financing statement is the naming of the debtor: "A financing statement is sufficient only if it ... provides the name of the debtor." §9-502(a)(1). Getting the name of the debtor right is clearly important, to provide a blinding glimpse of the obvious, because the filing office is required to index the filing under the name of the debtor. §9-519(f)(1). If an error is made in the name of the debtor in a financing statement, recovery of the filed financing statement through the search process is problematic.

As a result, an error in the debtor name, if the error fails to sufficiently provide the name of the debtor, renders the financing statement ineffective. §9-506(b). The recent case of *Pankratz Implement Co. v. Citizens Nat. Bank*, 33 Kan. App. 2d 279, 102 P.3d 1165, 55 U.C.C. Rep. Serv. 2d 245 (2004), review granted, (May 3, 2005), highlights the issue. In this case, the debtor's name was "Rodger House", but the secured party filed under "Roger House". Problems like the dropped "d" in *Pankratz* do happen. You can either self insure against these very serious clerical errors, or use our Insured Search™ and Insured Filing™ insurance products.

Again, we want to thank Steven O. Weise of the Los Angeles office of Heller Ehrman LLP for providing us with his most recent update to his 2005 *Commercial Law Developments*. Steve, in turn, would like to express his appreciation to the following for their important assistance in assembling these materials: John F. Hilson, Harry Sigman, Lynn Soukup, and Chris Rockers. We all also miss our good friend Jeff Turner.

CFS UCC SONG BOOK

At this year's joint dinner of the Commercial Financial Services Committee and the Uniform Commercial Code Committee of the Business Law Section held at the Annual Meeting of the American Bar Association in Chicago, a group of intrepid singers, some with voice, performed. The "Song Book" is dispersed throughout this Newsletter for your singing or reading enjoyment. The lyricist was none other than Lynn Soukup now of the Washington D.C. office of Pillsbury Winthrop. Although Lynn insists that she will keep her day job of corporate and commercial finance, some of us believe there is a great alternative for Lynn on Broadway.

CASES OF INTEREST

GRAFTON

The California Supreme Court unanimously held in *Grafton Partners, L.P. v. Superior Court*, Case No. S123344 (August 4, 2005) that pre-dispute contractual waivers of trial by jury are unenforceable. The Court analyzed California Code of Civil Procedure ("CCP") section 631, which implements article 1, section 16 of the California Constitution. Article 1, section 16 states that trial by jury is an inviolate right and for civil cases provides that "a jury may be waived by the consent of the parties expressed as prescribed by statute." The relevant statute is CCP section 631 which prescribes the six means by which parties to a civil lawsuit may waive their right to jury trial, including the filing of written consent with the clerk or judge. The Court held that CCP section 631 "presupposes a pending action" and that "only persons who already are parties to a pending action may enter into a waiver of jury trial as provided by the statute." The Court held that for a jury trial waiver to be valid, the execution and filing of the waiver must occur after litigation has commenced. Because a right to a jury trial is a significant public purpose, there is a significant debate whether closing a transaction involving a California borrower in New York, including funding to a bank account in New York, will be sufficient to avoid the conclusion in *Grafton*. Readers are advised to discuss the impact of *Grafton* on pending and future transactions with their counsel.

VANTAGEPOINT VENTURE PARTNERS 1196 V. EXAMEN, INC.

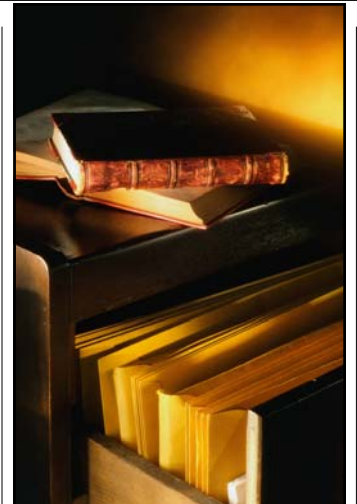
Earlier this year, the Delaware Supreme Court repudiated the "quasi-California corporation" statute (Cal. Corp. Code § 2115) when it held in *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005), that Delaware law instead of California law governs the voting rights of shareholders of a Delaware corporation. The VantagePoint decision, which affirmed a lower court ruling, relied on conflicts of law principles as well as the Commerce Clause of the U.S. Constitution.

The parties in this case were Examen, Inc. ("Examen"), a Delaware corporation involved in a pending merger with a subsidiary of Reed Elsevier Inc. and VantagePoint Venture Partners 1996 ("VantagePoint"), a Delaware limited partnership that held 83% of Examen's Series A Preferred Stock. Pursuant to the Delaware General Corporation Law and Examen's Certificate of Incorporation, the merger required the affirmative vote of a majority of the outstanding shares of common stock and Series A Preferred Stock, voting together as a single class. Under this method, VantagePoint controlled less than 15% of the vote.

Under Section 1201 of the California Corporations Code, however, the merger would require approval by the outstanding shares of each class of shareholders if Examen qualified as a "quasi-California corporation" under Section 2115 of the California Corporations Code. To qualify under Section 2115, a non-California corporation must conduct a certain level of business in California according to prescribed factors based on property, payroll and sales, and have more than half of its outstanding voting securities held by persons with addresses in California. With "quasi-California corporation" status, VantagePoint's majority ownership of Examen's Series A Preferred Stock would effectively give it veto power over the merger, under provisions of California corporate law.

At the initial stage at the Delaware Court of Chancery, the court concluded that the shareholder voting question concerned internal corporate affairs and that the internal affairs doctrine required the matter to be governed by the law of Examen's state of incorporation, Delaware.

On appeal to the Delaware Supreme Court, VantagePoint argued that "the issue presented by the case was not a choice of law question, but rather the constitutional issue of whether California may promulgate a narrowly-tailored exception to the internal affairs doctrine that is designed to protect important state interests." 871 A.2d at 1112. While affirming the lower court's reliance on the internal affairs doctrine, the Delaware Supreme Court addressed the constitutional issues directly and concluded that



DACA

(to the tune of Heartbreak Hotel)

I'm the depositary
 You better treat me right
 Indemnified, expenses paid
 Protected in a fight

Three party agreement, lender
 To get control
 To get control priority

You want a control agreement
 Well now we need to talk
 I don't get paid an awful lot
 I want the right to walk

Three party agreement, lender
 To get control
 To get control priority

Protection for your interest
 You get that with control
 You can exclude the debtor
 You can let it have a role

Three party agreement, lender
 To get control
 To get control priority

So call the ABA Taskforce
 They've got a form that's fair
 They've balanced parties' interests so
 We sign it everywhere

Three party agreement, lender
 To get control
 To get control priority

Let's Do Revisions Again

(to the tune of Time Warp from
The Rocky Horror Picture Show)

{Riff Raff}

Do you remember
Drafting sessions
Plugging every hole
Writing the comments

{Magenta}

To teach the judges

{Riff Raff}

The meaning of control

I remember revising the statute
Fixing every bad case
Now that it's finished I have the
feeling

{Riff Raff and Magenta}

We'd best pick up the pace

{Transylvanians}

Let's do revisions again
Let's do revisions again

{Narrator}

First NCCUSL's on board

{All}

ALI signs up too

{Narrator}

ABA gives a course

{All}

And you think we are through
It's knowing the answers that
really drives you insane
Let's do revisions again
Let's do revisions again

Section 2115 of the California Corporations Code created an intolerable lack of uniformity regarding such internal affairs as shareholder voting rights. This lack of uniformity was a defect of constitutional magnitude, in violation of the Commerce Clause.

The dismissive treatment given Section 2115 by both the Delaware Court of Chancery and the Delaware Supreme Court may cause some to query whether the "quasi-California corporation" statute is a dead letter. The answer is clearly yes – in Delaware. In California, however, Section 2115 remains good law, upheld by decisions of the California Supreme Court and the Court of Appeal.

PERSONAL PROPERTY SECURED TRANSACTION

SCOPE OF ARTICLE 9 AND EXISTENCE OF A SECURED TRANSACTION

CONSIGNMENTS

In re Georgetown Steel Company, LLC, 55 UCC Rep Serv 2d 475, 318 B.R. 352, 2004 WL 2861761 (Bankr. D.S.C. 2004) – A manufacturer that acquired steel that it incorporated into other goods engaged in a "consignment" transaction and not a "purchase" transaction because the goods were purchased for sale.

Comment: The "consignment" rules should apply only when the person receiving the goods plans to sell them in substantially the same form. Otherwise, most every purchase by a person other than the end-user would be turned into an Article 9 transactions.

LEASING

United Airlines, Inc. v. HSBC Bank USA, N.A., 416 F.3d 609 (7th Cir. 2005) – Court analyzed whether "lease" transactions were "true leases." Municipality sold bonds and turned the proceeds over to the airline, which used the proceeds to build airport facilities on land that the airline already leased. The airline sub leases the land to the municipality for \$1 and the municipality subleases the land back to the airline for "rent" payments equal to payments on the bonds. As a matter of federal law, only a "true lease" is a "lease" for purposes of Bankruptcy Code § 365. State law then determines the question of whether a particular transaction is a "true lease." Although the "lease" involved real property, the court noted the functional analysis of this question under UCC § 1-201(37). The court held that the "lease" was really a secured loan because (i) the "rent" payments were measured by the payments on the bonds and not by the market value of using the real property, (ii) at the end of the "lease" the airline ends up with exactly what it had at the beginning of the transactions, (iii) there was a balloon payment at the end of the "lease," and (iv) if the airline prepays the "rent," the two subleases end immediately, rather than the last sublease staying in place for its term.

SALES

Kipperman v. Netbank, FSB, 2005 WL 1365055, 56 UCC Rptr.2d 54 (Bankr. S.D.Calif. 2005) – A "buyer" bought payment streams under equipment leases. If the payment streams were purchases and the buyer was a "buyer" the buyer would have automatic perfection of its purchase. UCC § 9-309(3). If the payment streams were chattel paper or were a loan secured by payment intangibles, the "buyer" would have had to file a financing statement to perfect its rights. UCC § 9-310(a). The court first held that the asset purchased was "chattel paper" because the payment right was part of the "chattel paper." The court concluded that the transaction was a "loan" because the "seller" would receive any "excess" collections and the "seller" had to indemnify the surety that issued bonds to guaranty the collections.

Comment: If in fact *all* that was "transferred" was *only* the payment stream (without any of the other lessor rights under the lease, such as the right to take back the equipment on default), the right would be a "payment intangible." See 9-102, Comment 5(d) ("In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, nonmone-



tary obligations. If the promisee's right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor's obligation arose. When all the promisee's rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights."). The court cites another portion of this Comment, but does not cite this portion. The court is right that if the full lease is transferred, the embedded "payment intangible" remains part of the "chattel paper." Even if solely the payment stream is assigned, and the right assigned is a "payment intangible," if the seller later transfers the whole of the chattel paper to someone who takes possession under 9-330, the new transferee cuts off the payment intangible buyer.

SECURITY AGREEMENT AND ATTACHMENT OF SECURITY INTEREST

In re Yantz, 55 UCC Rep Serv 2d 19, 2004 WL 2280358 (Bankr. D. Vt. 2004) – A law firm did not have a security interest in an asset of its client where the client retainer letter did not refer to collateral. Notes taken by a paralegal for the lawyer (the purported secured party) referring to collateral did not suffice because the client (debtor) had not authenticated those notes nor did the authenticated retainer letter refer to those notes in any fashion. UCC § 9-203.

PERFECTION

POSSESSION, CONTROL AND OTHER PERFECTION METHODS

Maskell v. Bertone, 55 UCC Rep Serv 2d 179, 2004 WL 2451354 (Mass. Super. Ct. 2004) – A secured party had a PMSI in a boat. Generally, a secured party holding a PMSI in consumer goods has automatic perfection. The court held that that rule applied here, even though Article 9 says only that the filing of a financing statement is not necessary and does not dispense with registering the secured party's name on a certificate of title where that is the method of perfection. UCC § 9-309(1), 9-310(b)(2), 9-311(b).

Blue Ridge Bank and Trust Co. v. Hart, 55 UCC Rep Serv 2d 693, 152 S.W.3d 420, 2005 WL 41384 (Mo. App. 2005) – Security interest in vehicle held for sale by debtor was "inventory" and a security interest could be perfected only by filing of financing statement (or possession), but not by notation on certificate of title. UCC § 9-311(d).

PREPARATION OF FINANCING STATEMENT

In re Sho-Me Nutraceuticals, Inc., 55 UCC Rep Serv 2d 745, 319 B.R. 273, 2005 WL 39179 (Bankr. M.D. Fla. 2005) – Financing statement did not properly name debtor when secured party knew that original debtor was only "nominal" debtor and that real debtor would immediately take the collateral.

PRIORITY

PRIORITY-SET-OFF, CLAIMS OF UNSECURED THIRD PARTIES, BUYERS, AND RIGHTS OF HOLDERS OF NON-UCC LIENS

In re Iowa Oil Co., 55 UCC Rep Serv 2d 48, 2004 WL 2326377 (D. N.D. Ia. 2004) – A secured party's filing of a financing statement did not constitute notice to an account debtor of the assignment of its obligation so that the account debtor's set off rights were cut off. UCC § 9-404(a)(2).



I'm Perfected

(To the tune of "I Feel Pretty" from West Side Story)

I feel lucky
I'm perfected
An 11 is just days away
There's no preference
So trustee's not making me repay

First we filed
Took possession
And control of the entitlements
Seems we're covered
As to all the dollars and the cents

See the creditor in the corner there
He forgot to file on time
Now he's lost his place
He'll be getting paid
As another
Unsecured line

It's alarming
How its harming
If perfection is not on your list
So go back, check
On all the things you might have missed

RFC Capital Corp. v. Earthlink, Inc., 55 UCC Rep Serv 2d 617, 2004 WL 2980402 (Oh. 10th App. 2004) – Secured party agreement to allow debtor to sell collateral free of secured party's security interest may be an implied express authorization. UCC § 9-315. An agreement to allow the sale conditioned on the debtor's performance of its agreements with the secured party was not an implied authorization to sell the collateral free of the security interest in the absence of the debtor's performance.

PRIORITY—COMPETING SECURITY INTERESTS

General Electric Capital Corporation v. Union Planters Bank, 409 F.3d 1049 (8th Cir. 2005) – Under former Article 9, a secured party with a security interest in inventory allowed the proceeds of the inventory to be paid into a deposit account. Another secured party, unaware of the source of the funds, swept the account and applied the funds to the second secured party's claims. The court applied the lowest intermediate balance test to trace the first secured party's funds into the deposit account. Applying Comment 2(c) to former UCC § 9-306, the court held that the payments had been made in the "ordinary course of business" and that the second secured party took the funds free of the first party's security interest.

Comment: The same result undoubtedly would have occurred under revised Article 9. UCC §§ 9-315, Comment 3 (as to use of lowest intermediate balance); 9-332(b) (transfer of funds from a deposit account).

DEFAULT AND FORECLOSURE

NOTICE AND COMMERCIAL REASONABLENESS OF FORECLOSURE SALE

R&J of Tennessee v. Blankenship-Melton Real Estate, Inc., 55 UCC Rep Serv 2d 278, 2004 WL 2609201 (Tenn. App. 2004) – Although UCC § 9-611 requires only that the secured party "send" notice of a foreclosure sale to a secondary obligor, it was not commercially reasonable for a secured party to proceed with a sale ten days after sending the notice because the secured party had not received confirmation of the secondary obligor's receipt of the notice.

U.S. Bancorp Equipment Finance, Inc. v. Ameriquest Holdings LLD, 55 UCC Rep Serv 2d 423, 2004 WL 2801601 (D. Minn. 2004) – Secured party that held a security interest in an airplane was not required by commercial reasonableness requirement to allow defaulting debtor to lease the planes to new lessees not contemplated by the original loan documents. UCC § 9-610.

FINANCIAL INSTITUTIONS



REGULATORY AND TORT CLAIMS—GOOD FAITH, FIDUCIARY DUTIES, INTERFERENCE WITH PROSPECTIVE ECONOMIC ADVANTAGE, LIBEL, INVASION OF PRIVACY

Oakland Raiders v. National Football League, 131 Cal.App.4th 621 (2005) – A football team asserted that the football league owed the team a fiduciary duty. The court noted that ordinarily neither a contract nor a debt creates a fiduciary duty. The court distinguished the fiduciary duty owed by majority shareholders not to use unfairly their control to the detriment of minority shareholders. Here the football league is an unincorporated association. The league is not a joint venture because there is no sharing of profits and losses. Nor did the

commissioner of the league undertake fiduciary obligations where the league constitution expressly allowed the commissioner to undertake actions adverse to the interests of an individual team.

Smith v. Ajax Magnathermic Corp., 2005 WL 1767871 (6th Cir. 2005) – Lenders that allegedly took over management of a borrower could be liable for WARN Act (19 USC § 2101 et seq.). A lender that does no more than preserve its collateral does not become subject to the Act, but a lender that operates the borrower’s assets as a “business enterprise” may incur liability under the Act.

OBLIGATIONS UNDER CORPORATE LAWS

Vantagepoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del.Sup.Ct. 2005) – As a matter of choice-of-law rules and the Commerce Clause of the Constitution, the internal affairs doctrine requires the application of the law of the state of a corporation’s state of incorporation to “internal affairs.”

LETTERS OF CREDIT, INVESTMENT SECURITIES AND DOCUMENTS OF TITLE

INVESTMENT SECURITIES

Ogdon v. Hoyt, 55 UCC Rep Serv 2d 737, 2005 WL 66039 (N.D. Ill. 2005) – No statute of frauds applies to agreement to sell securities subject to Article 8. UCC § 8-113.

CONTRACTS

FORMATION, SCOPE, AND MEANING OF AGREEMENT



Eagle 9, Eagle 9
Every closing you need me
We'll assure
All's secure
For our usual small fee

Lenders we know
Like to get their dough
That is where we help out
We'll assure
All's secure
Let us get rid of all doubt

(tune of Edelweis from
The Sound of Music)

Falkowski v. Ellis, 2005 WL 2092925 (2005) – An employee stock option plan provided that the option lapsed if the employee ceased being an employee of the issuer or an affiliate of the issuer. An employee worked for a subsidiary and received options. The issuer sold the subsidiary. Although the employee remained employed by the former subsidiary, upon the sale of the subsidiary the employee was no longer employed by the issuer nor one of its affiliates. The court determined that the contract language was ambiguous, so it took parol evidence to determine what the parties had intended to say. The court construed the language of the option plan as a whole and reviewed the purposes of the plan in coming to its legal conclusion.

Fanucchi & Limi Farms v. United Agri Products - filed July 14, 2005. Cite as No. 0217252. California law allowing modification of written contract by "executed" oral agreement requires that oral agreement must have been fully performed. Language in written contract providing that "the written loan agreement may not be contradicted by evidence of any prior, contemporaneous, or subsequent oral agreements or understandings of the parties" precludes application of state law permitting oral modification of written contract with new consideration "[un]less the contract otherwise expressly provides." Evidence that parties entered into oral agreement that not only altered the timing and amount of debtor’s payments to lender but also included an agreement by lender to "release its equity" in debtor’s crops to permit debtor to obtain new crop financing, and that lender also agreed to forgive a portion of the debt after a period of time, was sufficient to establish triable issue of fact as to whether oral agreement was a novation.

ADHESION CONTRACTS, UNCONSCIONABLE AGREEMENTS, GOOD FAITH AND OTHER PUBLIC POLICY LIMITS INTERFERENCE WITH CONTRACT

Discover Bank v. Superior Court, 36 Cal.4th 148 (2005) – Arbitration agreement that precluded class arbitration was unconscionable in the circumstances and that the Federal Arbitration Act did not preempt California law in this area. Procedural unconscionability existed because the waiver of the right to bring a class action was included in a “bill stuffer.” The class action waiver could also function as an exculpation clause because the small amount of individual damages would discourage individual claims. The court referred back to the trial court the decision of whether a Delaware choice-of-law clause was enforceable due to the possible conflict with a fundamental public policy of California law.

Trend Homes, Inv. V. Superior Court, 131 Cal.App.4th 950 (2005) – Term in home purchase agreements to resolve disputes by judicial reference not unconscionable where there was neither procedural nor substantive unconscionability. There was no procedural unconscionability because the agreements were not adhesive, there was no evidence of the unavailability of alternative comparable housing, and the term was clearly written and conspicuous. There was no substantive unconscionability because it was not so one-sided that it would “shock the conscience.” It did not limit the amount or type of relief, nor the types of claims that a homeowner could bring.

JURISDICTION, CHOICE OF LAW AND CHOICE OF FORUM

Grecon Dimter, Inc. v. Horner Flooring Co., Inc., 55 UCC Rep Serv 2d 195, 2004 WL 2491576 (4th Cir. 2004) – German choice-of-law clause was enforceable under UCC § 1-105 where a principal component of the goods sold had been manufactured in Germany.

OTHER LAWS AFFECTING COMMERCIAL TRANSACTION

CONSUMER

Dunlap v. Credit Protection Association, 419 F.3d 1011 (9th Cir. 2005) – Applying the “least sophisticated investor” test under the Fair Debt Collection Practices Act, 15 U.S.C. § 1692e, the collection agencies name did not mislead a debtor into thinking that failure to pay a *de minimis* debt would result in damage to his credit.



PROFESSIONAL RESPONSIBILITY AND CONDUCT

Law Offices of Dixon R. Howell v. Valley - filed May 27, 2005, Sixth District. Cite as 2005 SOS 2576. Attorney's failure to give the statutorily mandated notice of client's right to fee arbitration is not an absolute bar to recovery of fees; dismissal of fee suit for failure to comply with the statute is discretionary on the part of the trial court. Client who asserted lack of notice of right to arbitrate as a defense to suit for fees, but actively defended the suit over a period of 15 months; acquired substantial discovery regarding plaintiff's claim, to plaintiff's prejudice; and made no effort to bring case to arbitration before moving for summary judgment on that defense waived right to arbitrate. Unsecured promissory note executed by the client—as contrasted with a promissory note given by the client secured by a deed of trust with a power of sale—does not give the attorney a present interest in the client's property required to trigger Rules of Professional Conduct, rule 3-300.

Cal West Nurseries, Inc. v. Superior Court (A.J. West Ranch, LLC) - filed May 31, 2005, Fourth District, Div. Three Cite as 2005 SOS 2625. Trial court erred in denying client's motion to disqualify firm representing it when firm sought to appear on behalf of adverse party in unrelated action against client; firm's withdrawal from the second representation only insofar as the pleadings involved rights and duties between the two clients, while continuing to represent second client as against parties other than the original client, was not sufficient to eliminate conflict of interest and did not support trial court's denial of disqualification motion.

Berg & Berg Enterprises, LLC v. Sherwood Partners, Inc. - filed July 29, 2005, Sixth District Cite as 2005 SOS 3609. Code of Civil Procedure Sec. 1714.10, which limits the circumstances in which an attorney may be sued for conspiring with a client, bars action by major creditor alleging that attorneys for assignee-for-benefit-of-creditors of corporate assets conspired with client to deplete assets of the as-

signor where claims were based solely on allegations that attorneys charged unnecessary and excessive fees in breach of alleged fiduciary duties of counsel to creditors adverse to client.

Virachack v. University Ford - filed May 20, 2005. Cite as No. 0355852. Where automobile sales program offered purchasers choice of a cash rebate or a reduced interest rate, and purchasers chose reduced interest rate, foregone rebate was not a "finance charge" for purposes of Truth in Lending Act.

Granholm v. Heald - filed May 16, 2005. Cite as No. 03-1116. State laws allowing in-state wineries but not out-of-state wineries to make direct sales to consumers discriminate against interstate commerce in violation of the Commerce Clause, and that discrimination is neither authorized nor permitted by the Twenty-first Amendment.

Filip v. Bucurenciu - filed May 24, 2005, Third District. Cite as 2005 SOS 2462. Uniform Fraudulent Transfer Act applies to property transactions associated with a marital dissolution and property settlement agreement.

Bronco Wine Company v. Jolly - filed May 26, 2005, Third District. Cite as 2005 SOS 2537. Business and Professions Code Sec. 25241, setting forth minimum standards for use of "Napa" on wine labels, does not violate state or federal constitutional rights of free speech, since standards merely prevent vintners from engaging in inherently misleading commercial speech. State's interests in protecting California wine consumers from misleading brand names of viticultural significance and in preserving and maintaining the reputation and integrity of its wine industry in out-of-state and foreign markets outweigh the indirect effect of Sec. 25241 on interstate commerce. Sec. 25241 does not effect a total taking of vintner's federally approved certificates of label approval, since the statute does not bar vintner from using its brand names under all circumstances and because vintner failed to establish that statute destroyed the substantial economic value of the brand names.

REAL PROPERTY

Bank of America, N.A. v. La Jolla Group II - filed May 19, 2005, Fifth District. Cite as 2005 SOS 2395. Where nonjudicial foreclosure sale was conducted by mistake after the homeowner and lender entered into an agreement to cure the homeowner's default and reinstate the loan—the lender having neglected to inform the trustee of the agreement before the scheduled auction at which the property was sold to a third party—the sale was void, issuance of deed to buyer did not vest ownership of property, and trial court was correct in restoring ownership to homeowner subject to deed of trust.

Local Filing Issues

Highlighted in our last issue of The Eagle 9® Newsletter was the Circuit Court's recent opinion regarding the IRS' obligation to file their liens in accordance with Revised Article 9's strict debtor name requirements. To briefly re-cap: the Sixth Circuit reversed a previous decision and held that while the IRS must "identify" the taxpayer and file within the state in which the property is situated, the Form 668 notice remains valid regardless of state law provisions. The court ruled that the exact legal name standards of RA9 were simply too burdensome to impart on our federal government and would conflict with the existing tax lien statute's goal of facilitating collection.

In light of this, searchers everywhere should be re-visiting their procedures for hunting tax liens. Debtor name aside, the very first piece of this puzzle goes to location. It is a common misconception that federal tax liens are filed at the Secretary of State (or central equivalent) while state tax liens are filed at the local recorder's office. Were all states as beautifully centralized as the great state of Louisiana, we'd be in luck. However, most jurisdictions have separate indexes at the states, recording offices and courts in which their tax liens are housed. The trick is knowing which index to search.

Take Massachusetts, for example. MA houses their state tax liens at the Secretary of Commonwealth's office only, while all federal liens can be found at the Boston District Court. The state of Vermont files no tax liens centrally; all are located at the town (or city) filing offices. New Hampshire chooses to index some state and federal liens at the Secretary of State, while other state and federal liens are found at the county *and* town (city) level.

We must also consider our debtor entity type. Tax liens for businesses are often filed in an index separately from liens against individuals. In Oklahoma, we nab our federal business entity liens at the Oklahoma county clerk's office—liens against the individual can be found in the county in which he or she resides. To further confuse the searcher, OK state tax liens on businesses are housed at the filing office in the county of the property...which may or may not be Oklahoma County.

Nervous yet? There's more...Tax liens against personal property are not necessarily recorded alongside real property liens. South Dakota's personal property liens are located at the state, while liens related to real estate are found at the county. Texas maintains personal property federal liens on businesses at the state, and personal property state liens on businesses at the county.

And now, enlightened by the Circuit Court's decision in *Spearing Tool*, selecting the correct index is still not enough. Searching the exact name could potentially keep one from discovering an effective tax lien. The "reasonably prudent searcher" standard has once again taken center stage. Now, the diligent searcher must consider the IRS' tendency to abbreviate debtor's name as well as add verbiage to the end of debtor's name—as is their common practice.

Though courts, governmental agencies, and other service companies may not be protecting the searcher, First American has developed products that do. Consider insurance on your larger transactions through a tax lien endorsement tied to your *EAGLE 9*® policy or a Combined Search Policy™ that not only insures the results of a tax lien search, but UCC, judgment and bankruptcy searches as well.

A UCC Article of Interest

Transition Issue Looms in Revised UCC Article 9

A transition issue under revised Article 9 of the Uniform Commercial Code may require special attention by our lender clients who make secured loans.

Revised Article 9, of course, went into effect in 46 states and the District of Columbia on July 1, 2001, and went into effect in the remaining states by January 1, 2002. Under the transition rules of revised Article 9, June 30, 2006, is an important date. That date is the outside date on which the effectiveness of financing statements filed under former Article 9 will lapse unless their effectiveness has been continued under the transition rules of revised Article 9.

This June 30, 2006, cut-off date for former Article 9 financing statements, created by revised UCC Section 9-705(c)(2), works very smoothly except for one scenario. That scenario is where a financing statement was originally filed in the **second** half of 1996 (or filed five or more years earlier and continued for a new five-year period beginning in the second half of 1996) and its effectiveness was continued by the filing of a continuation statement under former Article 9 early in the six-month continuation window in the first half of 2001 — before revised Article 9 went into effect. Under the rules of former Article 9 then in effect, the continuation statement would have continued the effectiveness of the financing statement to a date falling in the **second** half of 2006. Yet revised UCC Section 9-705(c)(2) provides that the outside lapse date for a former Article 9 financing statement is June 30, 2006 — i.e., at the end of the **first** half of 2006. The June 30, 2006, cut-off date for former Article 9 financing statements works very smoothly except for one scenario.

Consider the following example.

A former Article 9 financing statement was filed on November 1, 1996, and a continuation statement was filed under former Article 9 on May 2, 2001. Under the rules of former Article 9, the filing of the continuation statement would have continued the effectiveness of the financing statement for five years from the date on which it would have expired. Thus, application of the rules of former Article 9 would lead to the conclusion that the effectiveness of the financing statement was continued for five years from November 1, 2001, to November 1, 2006 — four months beyond the June 30, 2006, outside lapse date under revised Article 9.

How does the outside lapse date of June 30, 2006, operate, and how can a secured party maintain the effectiveness of a former Article 9 financing statement in this scenario? The answer depends in part on whether the former Article 9 financing statement is on file in the same state and same office as the state and office in which to file a financing statement to perfect the same security interest under revised Article 9.

If the office in which to file a financing statement to perfect the security interest under revised Article 9 has changed from the office specified under former Article 9 (e.g., a security interest with respect to which the debtor is a Delaware corporation with its chief executive office in New York), the outside lapse date for the financing statement filed and continued under former Article 9 is clearly June 30, 2006 (rather than, in the example above, the November 1, 2006 date supplied by the continuation rules of former Article 9); and its effectiveness can be continued beyond that date only by the filing of an "in lieu" initial financing statement (in Delaware in our example) no later than June 30, 2006. An "in lieu" initial financing statement can be filed at any time; there is no need to calculate a "window" in which this action

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must be taken.

If, however, the office in which to file a financing statement to perfect the security interest under revised Article 9 has not changed from the office specified under former Article 9 (e.g., the debtor is a California corporation with its chief executive office in California), the analysis as to the outside lapse date is more difficult. There are three possible legal theories suggesting different outcomes:

- Theory 1: The effectiveness of the former Article 9 financing statement will lapse on June 30, 2006. Under revised UCC Section 9-705(d), though, the effectiveness of the former Article 9 financing statement may be continued by the filing of a continuation statement. The normal six-month window for filing continuation statements applies; therefore, the continuation statement may be filed at any time in the first half of 2006.
- Theory 2: The effectiveness of the former Article 9 financing statement will lapse on June 30, 2006. Under revised UCC Section 9-705(d), though, the effectiveness of the former Article 9 financing statement may be continued by the filing of a continuation statement. However, calculation of the “continuation window” is a bit more complicated. Revised UCC Section 9-705(d) refers only to the “timely filing” of a continuation statement. Timeliness is determined by revised UCC Section 9-515(d), which states that a continuation may be filed “within six months before the expiration of the **five-year** period” of effectiveness. The only five-year period in sight, though, is the one that would end, in the example above, on November 1, 2006. Thus, under this theory, the continuation statement could not be filed earlier than May 1, 2006 (six months before the expiration of the **five-year** period of effectiveness under former Article 9), leaving only a two-month window in which to file the continuation statement.
- Theory 3: The third theory is that revised UCC Section 9-705(c) does not apply to a former Article 9 financing statement as to which the filing office did not change as a result of revised Article 9. This theory, while not easily justified by the literal language of the statutory text, is supported by the heading for that subsection: “Pre-effective date filing in jurisdiction **formerly** governing perfection.” Under this theory, the effectiveness of the financing statement in the example above would expire on November 1, 2006, and a continuation statement could be filed at any time during the six months before that date (i.e., on or after May 1, 2006).

This statutory ambiguity with respect to “same office, same state filings” causes two sets of problems — one for secured parties and one for filing officers. The problem for secured parties is how to continue the effectiveness of a former Article 9 financing statement that falls into this narrow category. One answer is easy: file a continuation statement during the period that is effective under all three theories. In the example above, all theories lead to the conclusion that filing a continuation statement between May 1, 2006, and June 30, 2006, will continue the effectiveness of the financing statement with no gap in its effectiveness.

The problem for filing officers is that their computer systems are typically programmed to reject continuation statements that are not filed during the correct window. Most such systems are programmed merely to count back six months from the listed expiration date. Thus, in the scenario that we have used as an example — a former Article 9 financing statement originally filed on November 1, 1996, and that was continued on May 2, 2001 — most of the automated systems in the filing offices will reject a continuation statement filed before May 1, 2006. The problem for secured parties is how to continue the effectiveness of a former Article 9 financing statement that falls into this narrow category.

Because neither secured parties nor filing officers can know which of the three legal theories will ultimately be adopted by a court, filing officers have been urged to accept for filing any continuation statement filed from January 1, 2006 through the lapse date under former Article 9 with respect to a financing statement as to which the correct application of UCC Section 9-705(c) is in doubt. Ultimately, a court will have to decide whether, in the context of our example, a continuation statement filed between January 1 and May 1, or between July 1 and November 1, is effective. We prefer the first theory (which would give effect to a continuation statement filed between January 1 and May 1 [as well as between May 1 and June 30], but would not give effectiveness to a continuation statement filed on or after July 1), and believe that a court should so rule. But even so, since under revised Article 9 a “record” (such as a continuation statement) is filed when tendered with the proper fee, it is better to have questionable continuation statements on the record where everyone can see them (even if they are ultimately adjudicated as ineffective) than to reject them with the result that they will be hidden even if a court concludes that they were effective.

The Permanent Editorial Board of the Uniform Commercial Code will likely issue an advisory report alerting filers to this issue. The International Association of Commercial Administrators, whose members operate the various state filing offices, is also closely monitoring the situation. In the meantime, our lender clients may wish to determine whether any of their former Article 9 financing statements may be affected by this transition issue. In this regard, note that the analysis in this *Alert* is based on the Official Text of UCC Section 9-705, which is in effect in most states. The rules differ in a few states, though. For example, in three states, the outside lapse date is later than June 30, 2006. In two other states, more specific guidance is given as to the period in which a continuation statement may be filed. As a result, the rules in effect in the state whose law governs perfection of each security interest under Revised Article 9 should be consulted.

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Silent Second

(Tune of "Desperado"
by Linda Ronstadt/The Eagles)

Silent second
You've got to stay in your corner
I'm not gonna warn ya
It's what we agreed
You're to be quiet
And let me handle the debtor
Decide on what compromise
And what remedy

Don't you think you've
got a vote in this
You gave me all of those rights
What's recovered comes to me -

I'm first in line
Well it seem to me the
payments due
Will exceed the debtor's assets
But you're only getting yours once
I've got mine

Silent second
High yield is your compensation
That's small consolation
When debtor's gone bad
We've an agreement
No limit on what I collect
You wait 'til I'm finished,
and I'll take my time

Don't you keep the payments
you've received
You did agree that money's mine
You know you gave your lender's rights away
You're booking losses on the loan
Ain't it awful how the profit's gone away

Silent second
You know that we made a bargain
With lawyerly jargon
I took the first lien
There's now a default
And I'm in charge of the work out
You better let me vote the claims
[Let me vote the claims]
You better let me vote the claims
And keep your nose out



These are all the same to the IRS.

Thanks to the recent **Spearing Tool** decision by the 6th U.S. Circuit Court of Appeals, the IRS can now file an effective federal tax lien under any one of these three versions of the debtor's name. And that's regardless of whether a searching creditor can find the notice of the tax lien using the State's standard search logic. So how can you protect yourself from being primed by an undiscovered Federal tax lien? **Get First American's EAGLE 9th UCC Insurance** with our tax lien endorsement. This protection guards against claims for lack of attachment, perfection, or priority of a security interest for commercial loans where personal property may be all—or part of—the collateral. It's the coverage you need to shift the clear risks of **Spearing Tool** to First American!

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