

THE EAGLE 9® NEWSLETTER

The First American Corporation
UCC DIVISION

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UCC EAGLE 9® policies insure the attachment, perfection and priority of the lender's security interest in 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. We hope that you find the Newsletter useful and that if you have any suggested topics or other matters you would like covered by the Newsletter, please let us know. The UCC Division wants to be of service to the commercial lending market, not only through our risk management insurance products, but also through our UCC search and filing services and other efforts, such as this Newsletter.

2005 was a very exciting year for the UCC Division. We doubled our financial performance over 2004 under almost any measurement and, to our customers, we say thanks! We attribute this growth not only to our innovative risk management insurance products but also to our willingness to service all commercial lending markets and not limit ourselves to real estate mezzanine lending. Additionally, there is an increasing awareness in the market of the utility of UCC insurance as a risk management tool, not only for the expansive UCC lien priority insurance coverage, but also as an alternative to the lender relying solely on the representations and warranties of the borrower, in the event that an opinion of borrower's counsel is unavailable, and as a cost effective alternative to many of the UCC operations of the smaller lender.

We have many to thank for this issue of the Newsletter. As always, we want to thank Steven O. Weise of HellerEhrman LLP, Los Angeles, for his summary of recent commercial law and bankruptcy cases. We also want to thank Steven N. Kurtz of Levinson Arshonsky & Kurtz, LLP for his excellent article on the recent Ohio Supreme Court case – *MP Star Financial, Inc. v. Cleveland State University*, 837 N.E.2d 758 (Ohio 2005) – decided on December 7, 2005 (a day that will live in infamy?). This case held that a governmental entity in Ohio that was an account debtor (an obligor on a service contract) was not required by UCC 9-406(a) to pay an assignee after notice of the assignment. The rationale was based upon Ohio's insertion of a non-uniform provision (adopted by a number of other states and which was part of former Article 9) making Article 9 inapplicable to "a transfer by a government, state or governmental unit." Steve's article, co-authored by Steve's associate Barak Vaughn, who did the research incorporated into the tables, is reprinted here by permission from the IFA from their January, 2006 Newsletter, www.factoring.org.

While one clear reading of "transfer" includes grants of security interests (or other transfers covered by Article 9 such as sales of accounts and chattel paper or certain consignments), the Ohio Supreme Court held that payments made or to be made by a governmental account debtor are also to be included. An obvious extension of the court's analysis makes Article 9's rules concerning anti-assignment provisions and waivers of defenses also inapplicable to governmental account debtors. One would thus be left to look at other state statutes or common law – a course of action apparently not pursued by the court in this case.

Further, as discussed by Ken Kettering of New York Law School on the UCC ListServ, "For a court to err in its interpretation of Article 9 is nothing new. What surprises me about this case, more than the court's construction of Ohio's Article 9, is the court's conclusion that because 9-406 doesn't apply, the assignee must lose, tout court. As Bob Ihne's initial post rightly stated, the conclusion that 9-109 takes 9-406 off the table in this case should mean only that the issue is governed by other law. And the common law of contracts parallels 9-406(a) in stating, in effect, that the account debtor can't discharge his obligation by paying the assignor after the account debtor has received notice of the assignment. See Restatement (Second) of Contracts §338(1) & cmt. e; Restatement of Contracts §170(2)(a). So it's a mystery to me why the assignee shouldn't win even given the Ohio Supreme Court's conclusion that 9-406 does not apply. Perhaps there might be some quirk in the Ohio common law of contract assignments, or some-

thing in Ohio law specific to obligations of governmental entities (perhaps some emanation from the notion of sovereign immunity?), that would override the common law principles set forth in the Restatements, but there's no mention of anything like that in the opinion. It seems that this point wasn't raised: the briefs filed with the Ohio Supreme Court are online at Westlaw, and they do not, so far as I can see, make any reference to the law that applies if 9-406 doesn't apply. "

Finally, as discussed in detail in the Report titled "Maintaining Perfection Beyond June 30, 2006 of Security Interests Created And Perfected By Filing Under Former Article 9 (the "Report")" of the Permanent Editorial Board for the Uniform Commercial Code, there is an interpretive issue concerning the further continuation of certain financing statements that were continued during the first half of 2001. In particular, application of UCC §9-705(c) provides that a financing statement that was effective under former Article 9 remains effective under revised Article 9 (even if the financing statement was filed in a jurisdiction that is not the jurisdiction whose law governs perfection under the conflict of laws rules in revised Article 9). The period of effectiveness of such a financing statement under revised Article 9 is limited, though. UCC §9-705(c) goes on to provide that the pre-effective-date financing statement ceases being effective under revised Article 9 at the earlier of (i) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it was filed and (ii) June 30, 2006 (the "cut off date"). As the cutoff date approaches, secured parties must plan carefully to assure that the perfected status of their security interests that remained effective under UCC §9-705(c) continues after that date. This Report generally describes the effect of the cutoff date and the actions that secured parties may take to maintain the perfection of their security interests and analyzes in particular detail the effect of the cutoff date on certain financing statements that were continued during the first half of 2001.



At **First American's UCC Division**, we make it our total focus to protect your interests on commercial loan transactions. Simply put, we provide the complete coverage that asset-based lenders like Mark Hafner of Celtic Capital can rely on.

"At Celtic Capital we use First American for a number of reasons. We're in a market where a legal opinion from a borrower's counsel is too expensive. But, we still want a level of assurance greater than just relying on the reps and warranties of the borrower. With **First American's EAGLE 9® Lender's Policy**, we get that additional assurance. It protects us against the technical problems that keep us up at night, such as the accuracy of the debtor's name and filing office error. And although it's our process to prepare and file our financing statements directly, we know that First American could serve as our UCC back office if needed. We're very pleased with First American and plan on continuing the relationship for years to come.

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As discussed in detail in the Report, there is an interpretive issue concerning the further continuation of certain financing statements that were continued during the first half of 2001. In particular, the application of UCC §9-705(c) to such continued financing statements that are filed in the same office in the same state as required by revised Article 9 is particularly problematic and may not have been intended by the drafters. Consequently, resolution of the interpretive issue must be accomplished either by interpretation of UCC §9-705 in light of both its text and the absence of clear evidence of statutory intent or by concluding that §9-705 does not address such continued financing statements and, thus, the cutoff date is inapplicable to them. The Report takes no position as to the correct interpretation. As the Report indicates, though, under any interpretation a secured party wishing to continue such a financing statement can avoid the risk of an untimely (and, therefore, ineffective) continuation if it files a new continuation statement during a period that begins six months before the effectiveness of the financing statement would otherwise lapse without regard to the June 30, 2006, cutoff date and that ends on June 30, 2006. It should be noted, however, that this "safe harbor" window for filing a continuation statement does not provide the full six-month period for filing continuation statements contemplated by both former UCC §9-403(3) and revised UCC §9-515(d).

Cases of Interest

PERSONAL PROPERTY SECURED TRANSACTIONS

SCOPE OF ARTICLE 9 AND EXISTENCE OF A SECURED TRANSACTION—GENERAL

In re Chris-Don, Inc., 57 UCC Rep Serv 2d 496, 367 F. Supp. 2d 696, (D.N.J. 2005) – Secured party did not have a security interest in a liquor license because under New Jersey law the liquor license was not personal “property.” The court rejected the view that Article 9 overruled the New Jersey’s Alcoholic Beverage Statute, because Article 9 only applies to “property.”

MP Star Financial v. Cleveland State Univ., 58 UCC Rep Serv 2d 191, 837 N.E.2d 758 (Ohio 2005) – Article 9 does not apply to an assignment of an account by an obligee on an account where the account debtor is a governmental entity. The decision is based on non-uniform 9-109(d)(14), which excludes “a transfer by a government, state, or governmental unit.” The Ohio Supreme Court held that the payment of the account by an account debtor that was part of the state “government” was a “transfer” within the purview of the exclusionary provision. As a consequence, the assignee’s claim under 9-406(a) against the account debtor, which made payment to the assignor despite notice of the assignment, was dismissed.

Comment: 9-109(a), Article 9’s scope provision, begins “Except as otherwise provided in subsections (c) and (d), this article applies to: . . .” Ohio’s exclusion of “transfers” by governmental agencies is in subsection (d), one of the subsections specifically mentioned in 9-109(a) as qualifying the reach of 9-109(a). The logical reading of the word “transfer” in the context of subsection (d) is by reference to the “transfers” covered by subsection (a). The only transfers covered by subsection (a) are those by debtors, not those by account debtors (such as the government in this case). See *Deal v. United States*, 508 U.S. 129, 132 (1993) (Scalia, J) (“Petitioner’s contention overlooks, we think, this fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used.”)

SECURITY AGREEMENT AND ATTACHMENT OF SECURITY INTEREST

Jerke Construction, Inc. v. Home Federal Savings Bank, 56 UCC Rep Serv 2d 125, 693 N.W.2d 59 (S.D. 2005) - A buyer entered into an agreement to buy equipment. The buyer took possession of the equipment and made some payments with funds provided by another person. The court concluded that the person who supplied the funds was the true buyer of the equipment and not the nominal buyer. Thus the nominal buyer had only “naked possession” of the equipment and did not have “rights in the collateral.” Thus the secured party of the nominal buyer did not have a security interest in the equipment. UCC §9-203.

PERFECTION— POSSESSION, CONTROL AND OTHER PERFECTION METHODS

Greenfield Commercial Credit, L.L.C. v. Comerica Bank, et. al., 2005 Mich. App. LEXIS 1513 (2005) – In the absence of special instructions regarding a deposit, “banks are not required to treat deposits as special deposits, despite the bank’s knowledge of the security interests of the third parties.” The court explained that of itself knowledge by a bank of a security interest held by third parties does not affect the general priority rules for deposit accounts which provide that “a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.” Therefore, banks have the superior security interest over any funds that are deposited into the bank’s deposit account without special instructions to hold the funds in trust for the benefit of a secured party. Consequently, the court held that the deposit bank did not violate the third-party creditor’s security interest when the bank swept the funds held in debtor’s business account to pay down an outstanding loan debtor had with the bank.

McFarland v. Brier, 54 UCC Rep Serv 2d 74, 850 A.2d 965, 973-77 (R.I. 2004) – Under UCC § 9–102(a)(29) a certificate of deposit (“CD”) falls under the collateral classification of an “instrument” or a “deposit account.” If it’s an “instrument” the security interest is perfected by possession of the CD or by the filing of a financing statement. UCC § 9–312(a) and 9–313(a). If it’s a deposit account, then the only way to perfect the security interest is by obtaining control of the deposit account. UCC § 9–312(b)(1). This case sheds additional light on the past confusion over the appropriate collateral classification under Article 9 for CDs, which ranged from classifying a CD as an “instrument” perfected by possession, a “deposit account” perfected by control, a “general intangible” perfected by filing a financing statement, or none of the above.

Union Planters Bank, N.A. v. Peninsula Bank, 56 UCC Rep Serv 2d 356, 897 So. 2d 499 (Fla. Dist. Ct. App. 2005) - A rental company that sold cars after their use for rental purposes was not in the business of selling cars. Thus, even though holding cars to rent is holding them as inventory, the ability to perfect a security interest by the filing of a financing statement was not available because the statute allows that only for a person “in the business of selling goods of that kind.” UCC §9-311(d). The court applied non-UCC rules in state law to conclude that the rental company was not in that business.

Comment: The court could also have cited UCC §9-311, Comment 4 (“For example, if goods are subject to a certificate-of-title statute and the debtor is in the business of leasing but not of selling, goods of that kind, the other subsections of this section govern perfection of a security interest in the goods. The fact that the debtor eventually sells the goods does not, of itself, mean that the debtor ‘is in the business of selling goods of that kind.’”)

PRIORITY

In re Aquamarine USA Inc., 56 UCC Rep Serv 2d 309, 319 B.R. 270 (Banker. M.D. Fla. 2004) - An owner of goods “entrusted” them to a third party to sell and the third party agreed to pay the owner after the goods were sold. The third party sold the goods in ordinary course and the buyer took free of the owner’s rights because the third party had the power to transfer all of the owner’s rights. UCC §2-403.

Comment: The court missed the fact that revised Article 9 treats these consignment transactions as a “security interest” (UCC §1-201(37)) and that the buyer would have also taken free as a BIOCIB (UCC §9-320) and as a buyer from a seller who had granted a security interest that was not perfected (UCC §9-317(b)).

Allan Nott Enterprises, Inc. v. Nicholas Starr Auto, LLC, 56 UCC Rep Serv 2d 820, 2005 WL 696839 (Ohio Ct. App. 2005), appeal allowed, 832 N.E.2d 735 (Ohio 2005) - A buyer of goods who gave a dishonored check had a voidable title and could transfer good title to a good faith purchaser for value. UCC §2-403.

RFC Capital Corp. v. Earthlink, Inc., 55 UCC Rep Serv 2d 617, 2004 WL 2980402 (Ohio Ct. App. 2004) – A third party purchased collateral subject to a perfected security interest. Courts are split over whether by including conditions to a release, a secured party loses its ability to pursue the collateral after it is transferred to a third party. This decision holds that the conditions do not cut off the security interest but instead place a burden on the third-party purchaser to determine that the conditions were satisfied.

Mims v. First Citizens Bank, 56 UCC Rep Serv 2d 383, 913 So. 2d 1098 (Ala. Civ App. 2005) - A secured party perfected its security interest by filing a financing statement. A few years later a second secured party obtained a security interest in the same collateral and perfected its security interest in the collateral by filing a financing statement. The first secured party later assigned its rights and the assignee filed a new financing statement. The assignee also took possession of the collateral before the first secured party's financing statement lapsed. The court correctly held that the assignee had priority because its security interest had been the first to be filed and it had been continuously perfected through the possession. Former UCC §§9-303(2), 9-312(3). Had the assignee of the first secured party not taken possession of the collateral it would have had a junior security interest because the new financing statement that it had filed did not "continue" the original financing statement filed by the first secured party and thus would not have "related back" for priority purposes.

Comment: The same result concerning continuous perfection would occur under revised Article 9. UCC §9-308(c).

In re Wiersma, 56 UCC Rep Serv 2d 452, 324 B.R. 92 (Bankr. 9th Cir. 2005) - A secured party had a security interest in cows. Due to the negligence of a contractor, the cows suffered electrical shocks and were injured. The owner of the cows had a commercial tort claim against the contractor. The claim was settled and the contractor owed the settlement amount to the owner. The secured party had a security interest in the settlement obligation both as proceeds of the cows and as a "payment intangible" covered by its security interest. UCC §9-102, Comment 15 (amount owed in settlement of commercial tort claim is no longer a "commercial tort claim" and becomes a "payment intangible"), 9-322(b)(1), Example 5.

DEFAULT AND FORECLOSURE

Motors Acceptance Corp. v. Rozier, 54 UCC Rep 2d 31, 597 S.E.2d 367 (Ga. 2004) - Repossessed collateral remains property of the debtor until the secured party goes through additional steps to obtain ownership, such as selling the collateral or agreeing to retain it in satisfaction of the debt.



New Edge Network, Inc. v. Britsys, Inc., 55 UCC Rep Serv 2d 861, 2005 WL 103083 (Wash. Ct. App. 2005) - A Wholesale provider of Internet access had an agreement with a retail provider, who in turn sold access to end-users. When the retail provider defaulted, the wholesale provider terminated the agreement with the retail provider and migrated the end-users to other retail providers. The termination of the agreement and the migration of the customers was not a "foreclosure" subject to UCC Article 9.

Layne v. Bank One, Ky., N.A., 55 UCC Rep Serv 2d 704, 395 F.3d 271 (6th Cir. 2005) - A secured party's sale of pledged stock on the NASDAQ market was commercially reasonable and the lender had no obligation to sell the pledged stock earlier solely due to a decline in the stock's market value. UCC § 9-207.

State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, 374 F.3d 158, 168-71 (2d Cir. 2004) - Court addressed whether under New York law a lender breached the covenant of good faith and fair dealing implied in all contracts by withholding its consent to a defaulting borrower's proposed disposition of assets. In evaluating a lender's duties in granting or withholding consents under a credit agreement, the court held that, regardless of the implied covenant, if a contract permits a lender to withhold consent for particular conduct and if such contract fails to set express restrictions on the lender's right to do so, the lender is under no obligation to reasonably or unarbitrarily grant or withhold its consent.

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GUARANTIES

Marc Nelson Oil Products, Inc. v. Grim Logging Co., 110 P.3d 120 (Or. Ct. App. 2005) – Surety was not obligated to pay an assignee of the beneficiary where there was no previous or simultaneous consent to the assignment of the guaranty.

Strather v. Detroit Discount Distributors, Inc., 56 UCC Rep Serv 2d 681, 2005 WL 625460 (Mich. Ct. App. 2005) - A person who signed a note to secure the reimbursement of the issuer of a letter of credit could not seek contribution from independent guarantors of the accommodated party's debt because they were not "parties" to the instrument and thus no statutory right of reimbursement applied, UCC §3-419, nor was the maker of the note subrogated to any claims against the guarantors because the guaranties were not "collateral."

Trust One Mortgage Corp., v. Invest America Mortgage Corp., 134 Cal. App. 4th 1302, 37 Cal. Rptr. 3d 83 (2005) - An "indemnification" agreement from a person who is not the borrower is not subject to California anti-deficiency laws. California law applied to the foreclosure of Georgia real estate because of a California choice-of-law clause in the indemnification agreement. The court held that the *Gradsky* set of issues did not apply because the agreement was an "indemnification" agreement and not a "guaranty."

Comment: The conclusion that the agreement was not a "guaranty" seems wrong with respect to the particular claim. Although the indemnification did cover some third party obligations, to the extent it covered making the lender whole for any deficiency on the loan, it was a "guaranty."

FINANCIAL INSTITUTIONS

REGULATORY AND TORT CLAIMS

In re Enron Corp., 333 B.R. 205, 2005 Bankr. Lexis 2218 (Bankr. S.D.N.Y. 2005) - Court may subordinate a claim based on conduct unrelated to the claim itself. The subordination applies to transferees of the claim.



UCC– SALES AND PERSONAL PROPERTY LEASING

WARRANTIES AND PRODUCT LIABILITY

Computer Network, Inc. v. AM General Corp., 56 UCC Rep Serv 2d 425, 265 Mich. App. 309 (Mich. Ct. App. 2005) - A buyer of a car brought it in for repairs seventeen times over the first twenty one months of ownership. The selling dealer duly fixed the car each of those times. There was no breach of warranty where the seller had made good on its promise under the warranty to fix any defects. There was no independent breach of warranty arising out of the cumulative effect of all of the (fixed) problems.

Sharp v. Tom Wood East, Inc., 56 UCC Rep Serv 2d 101, 822 N.E. 2d 173 (Ind. Ct. App. 2004) - A person bought a used car that had 64,669 miles on it. The buyer then drove the car an additional 22,000 miles. The buyer then brought an action for breach of the warranty of merchantability. The court held that given all of this driving, the car had been merchantable at the time of acceptance. UCC §2-314.

PERFORMANCE, BREACH AND DAMAGES

Enron Power Marketing, Inc. v. Nevada Power Co., 55 UCC Rep Serv 2d 31, 2004 WL 2290486 (S.D.N.Y. 2004) - Right to demand reasonable assurance of performance was not automatically triggered by a downgrading of the credit of a party to the agreement where the contract had a general clause dealing with this issue. While the contract could have made express provision for that result, in the absence of an express provision, the court should evaluate the reasonableness of the demand in the circumstances.

LETTERS OF CREDIT, INVESTMENT SECURITIES AND DOCUMENTS OF TITLE

LETTERS OF CREDIT

Hendricks v. Bank of America, 408 F. 3d 1127 (9th Cir. 2005) - Court could enjoin the issuer of a letter of credit from honoring a draw under the letter of credit if the applicant could show material fraud. UCC §5-109. The court was entitled to enter the injunction even if the fraud involved the underlying transaction (creating a fictitious right to draw) instead of the draw itself. The court reserved the question of whether the person seeking the injunction under UCC §5-109 had to show irreparable harm, as would ordinarily be necessary for an injunction.

Middlesex Bank & Trust Co. v. Mark Equipment Corp., 56 UCC Rep Serv 2d 443, 2005 WL 446035 (Mass. 2005) - The issuer of a letter of credit properly honored the letter of credit under the strict compliance rule even though the draw request misstated the date of the issuance of the letter of credit. The Court held that the strict compliance rule did not require a "hypertechnical" reading of the letter of credit where "there is no possibility that the documents could mislead the paying bank to its detriment." UCC §5-108, ISP 98, Rule 4.

CONTRACTS

JURISDICTION: CHOICE OF LAW AND CHOICE OF FORUM

Marrone v. Meecorp Capital Mkts., LLC, No. Civ. A. 04-3335, 2004 WL 2677175 (E.D. Pa. Nov. 19, 2004) - Court upheld a forum selection clause, noting that absent inconvenience or fraud and given that parties to the case were located in the chosen forum state there was no reason to disregard the choice.

DAMAGES

Delta Rault Energy 110 Veterans, L.L.C. v. GMAC Commercial Mortgage Corp., No. Civ A. 04-139, 2004 U.S. Dist. LEXIS 15136, at *1 (E.D. La. Aug. 4, 2004) – Court upheld an “exit fee” provided for in a mortgage agreement as it found the “exit fee” to be either an additional fee or deferred interest added as consideration for making the loan.

Other Laws Affecting Commercial Transactions

BANKRUPTCY CODE

AVOIDANCE ACTIONS

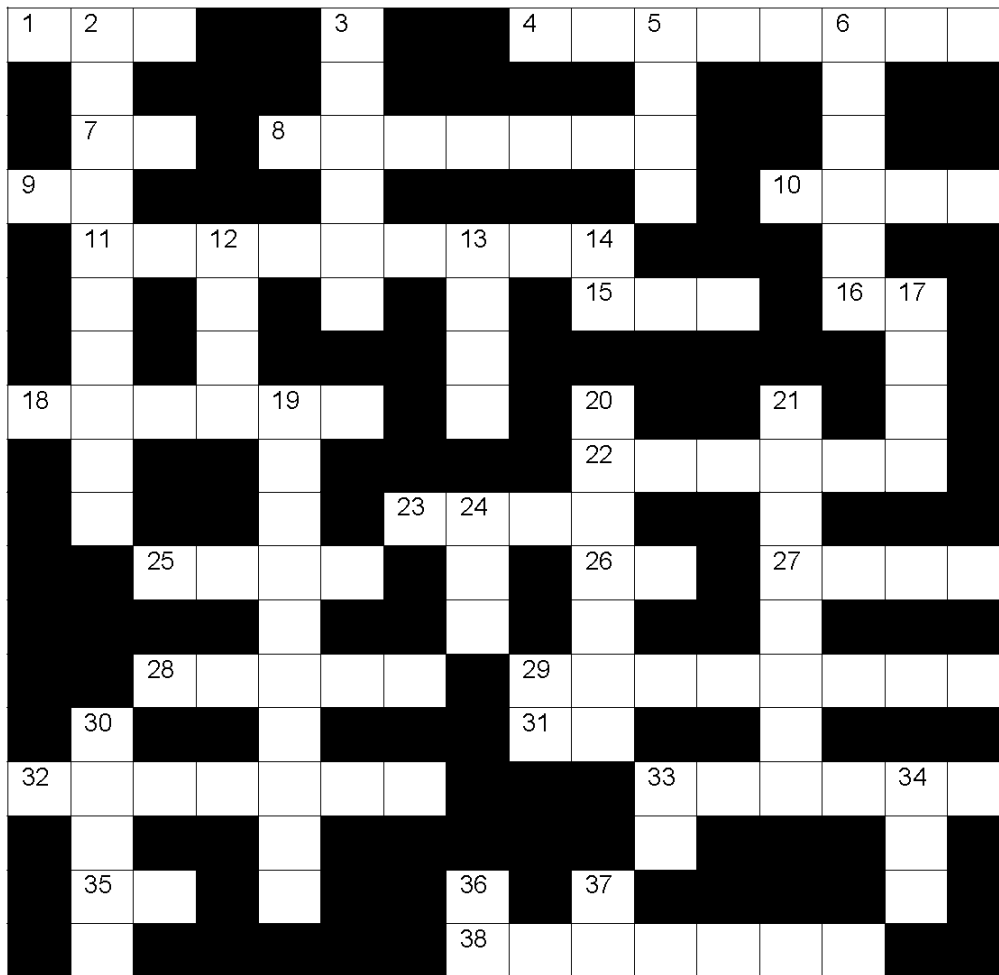
Central Virginia Community College v. Katz, filed January 23, 2006, Cite as No. 04-88- Bankruptcy trustee’s proceeding to set aside debtor’s preferential transfers to state agencies is not barred by sovereign immunity.

In re Computrex, Inc., 403 F.3d 807 (6th Cir. 2005) – Case involved a disbursing agent that processed freight charges and that commingled client funds. Even though the disbursing agent exercised some discretion in which payments it sent out first, the payments were not preferential payments by the disbursing agent prior to the disbursing agent’s bankruptcy.

Request for rehearing DENIED—still good bad law.



Local Filing Issues

**ACROSS**

1. Choice of
4. This document could have embedded fixture language
7. Don't forget to pay recordation tax in this state
8. Get their names right!
9. This state has central indexing (abbrev.)
10. Financing Statement, for one
11. Secured party of a consignment
15. = & (for the IRS)
16. In this state, file with the Dept. of Treasury (abbrev.)
18. Decline to accept (a filing)
22. You're required to do this to perfect a Purchase Money Security Interest
23. This could trump you (abbrev.)
25. Congruent with a purchase
26. Pay documentary stamp tax in this state (abbrev.)
27. "Spearing _____"
28. Ownership
29. The **EAGLE 9®** UCC Insurance Policy insures attachment, perfection, and this
31. UCC-3 (abbrev)
32. A way to perfect
33. Secured party of a lease
35. File at the Recorder of Deeds here (abbrev.)
38. These states require SSN's

DOWN

2. Sometimes leads to automatic perfection
3. One's "tab"
5. Insurance is the assumption of this
6. Transfer
12. Box #1a
13. No. of articles in the Code
14. __ 9
17. On the 1st day of this month in 2001, most states adopted
19. All assets, for one
20. The "U"
21. Personality turned real property
24. = Manufacturing (for the IRS)
29. Formerly a dual filing state
30. All things that are moveable
33. This state has central indexing (abbrev.)
34. Could be as-extracted collateral, for one
36. "Org. __"
37. File with the Dept. of Natural Resources here

A UCC Article of Interest

**REPORT OF
Steven N. Kurtz
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IFA General Counsel
(Financing Statement Government Accounts)**

One of the services that the IFA offers to its members is the Amicus Brief Program, where the IFA has taken positions in various appellate cases which are of interest to the association and its members. One of its cases was *MP Star Financial, Inc. v. Cleveland State University*, 107 Ohio St.3d 176 (2005). Unfortunately, on December 7, 2005, the Ohio State Supreme Court ruled against one of its members, MP Star Financial, with whom the IFA participated in the case.

The facts in this case are simple. The factor entered into a financing arrangement with its client. The factor client conducted business with Cleveland State University and sold various accounts to the factor. Cleveland State University received a proper notice of assignment which instructed the University to render payment to the factor instead of the factor client. Cleveland State University paid the factor client instead of the factor. The factor client failed to remit the money to the factor. The factor sued Cleveland State University for failure to comply with the notice and the trial and intermediate appellate courts held that the assignment provisions of the UCC did not apply to governmental entities. The factor appealed and the IFA filed an amicus brief. The Ohio State Supreme Court then granted review.

The issue in the case was whether or not the assignment provisions of the Ohio version of UCC Sec. 9-406 (the UCC assignment provisions) apply to a state government entity. This issue turned on a reading of the Ohio version of the "step back" provision of the UCC, found in Ohio's version of UCC Sec. 9-109. The UCC Step Back provision sets forth the types of transactions which are not covered by Article 9, and generally exclude transactions where state law or federal law provides an alternative means of registering a security interest, such as motor vehicles (unless it is inventory), aircraft, or registered copyrights. The step back provision also addresses loans to state governments and governmental units.

Revised Article 9 also states in Sec. 9-109(c)(2) that it does not apply if another statute of the state expressly governs the creation, perfection, priority, or enforcement of a security interest created by the state or governmental unit of the state. This means that a security interest granted by a state or governmental unit of the state is governed by Article 9 unless the state created a different law which governs such transactions. The comments to Sec. 9-109(c)(2) clearly reinforce this point. Revised Sec. 9-109(c)(2) replaced a prior section which stated that Article 9 does not apply to a transfer by a government or governmental unit.

Unfortunately, Ohio has not adopted Revised Article Sec. 9-109(c)(2). Rather, it uses the prior version of the step back statute, which states that Article 9 does not apply to a transfer by a government or governmental unit. In fact, as set forth in the chart at the end of this article, Ohio is one of many states which have not adopted this section of Revised Article 9. In fact, California adopted this section with its own language, but amended the statute to go back to the prior wording in place before Revised Article 9.

Although Ohio, like several states, has not adopted Revised Article Sec. 9-109(c)(2), there were many decisions and well regarded authorities which held that the notice provisions of UCC 9-406 (and its predecessor section 9-318) apply to state governments and governmental units. Although Ohio has not adopted Revised Article 9-109(c)(2), it adopted the official comments to that section, which reinforces the rule that Article 9 should apply to security interest created by states or governmental units unless there is a specific law to the contrary.

Although it is clear that Revised Article 9 and old Article 9 did not have any intention to exclude state governments or governmental units from the notice provisions, the factor was still faced with the classic sympathy problem of the notice provisions-requiring an account debtor to pay twice. In this case, there were no sympathetic facts in the record which would reflect that Cleveland State University was duped or tricked into paying the wrong party. Rather, the University simply paid over notice. However, the factor was still faced with Ohio Supreme Court Justices, on a state payroll, effectively requiring their team to pay twice.

The Ohio Supreme Court based its decision, without any analysis, on a dictionary meaning of the word transfer, which defined a "transfer" as: the conveyance or removal of something from one place, person, or thing to another. The Court further determined that the word transfer was unambiguous and therefore there was no need to look to the official comments, which would have dictated that the court rule in favor of the factor.

All factors who purchase invoices of account debtors who are state governments or governmental units in any of the states which do not follow Revised Article Sec. 9-109(c)(2), should be aware of this decision. Although the case was wrongly decided and contained several analytical flaws, there is a risk that other judges, who are state employees, may pick up on this trend.

For those who do not want to wade in these waters, the simple solution is to not purchase state government or governmental unit invoices.

If you decide to purchase such invoices, one may obtain a form of an estoppel letter, which essentially states the entity received the goods or services from the factor client and promises to pay the factor client. This creates a contract in favor of the factor where payment to the factor client results in a breach.

Many state governments or governmental units have their own internal procedures which will ultimately result in the direction of payment to the factor. In a bureaucratic world, this makes perfect sense. Compliance with these procedures creates an enforceable contract in favor of the factor. Some states may have procedures which are similar to the Federal Assignment of Claims Act, which if followed, result in payment to the factor and an obligation which the factor can enforce.

If the factor has its client's cooperation, the actual agreement between the factor client and the state or the governmental unit can provide that all payments be made to the factor. Provided that there are no state specific assignment of claims provisions which must be complied with, this results in the factor being a third party beneficiary to the actual contract who can enforce a claim for nonpayment, independent of the UCC assignment provisions.

One final suggestion, is to have a choice of law provision in the agreement (or invoices) between the factor client and the state or governmental unit which calls for the law of a state which has adopted Revised Article Sec. 9-109(c)(2). Revised Article 1-301(c) allows the parties to choose the law of any state, regardless of whether or not the transaction bears any relation to the state. If the state has adopted Revised Article 1-301(c) and you can get your factor's client's cooperation by at least inserting a proper choice of law clause into an invoice, this may be a way around the Cleveland State University decision. If the state has not adopted this section, then the transaction must bear a reasonable relationship to the chosen state (UCC Sec. 1-105). One caveat about using this tactic is that conflict of law rules can be quite complicated and a court being sympathetic to the plight of its ultimate employer being forced to pay twice on the same invoice, can always find a reason not to apply the contractual choice of law provision as it violates some state policy. At the end of this article is the list of states which have adopted revised UCC Sec.1-301(C).

The Cleveland State University decision requires that those who transact business with state governments or governmental units be quite vigilant and aware of the rules and playing field they are dealing with. If the state where the government account debtor has adopted Revised Article Sec. 9-109(c)(2), then the playing field becomes more even. If the state has not adopted this section, then one must exercise caution and hopefully the suggestions set forth above will be of some assistance. Of course, the ultimate reality is that when dealing with state or governmental unit account debtors, you are asking a court to cause its ultimate employer to pay twice on the same invoice, which is a rough task. Finally, further verification and monitoring of these accounts are the best method to prevent problems of this sort.

TABLE 1

TREATMENT OF GOVERNMENTAL TRANSFERS UNDER REVISED ARTICLE 9

Jurisdictions	UCC Section 9-109(c)(2) Adopted	Cite
Alabama	No	ALA.CODE S 7-9a-109
Alaska	No	AK 45.29.109(d)(14)
Arizona	No	AZ ST s 47-9109(D)(14)
Arkansas	No	ARK.CODE s 4-9-109(d)(14)
California	No	CA COML CODE s 9109
Colorado	No	CO ST s 4-9 109
Connecticut	No	CT ST s 42A-9-109(d)(14)
Delaware	Yes	DE ST ti 6 s 9-109
District of Columbia	Yes	D.C. CODE s 28:9-109
Florida	No	FL ST s 679.1091(4)(n)
Georgia	No	GA CODE s 11-9-109
Hawaii	No	HI ST s 490:9-109(d)(14)
Idaho	Yes	IDAHO CODE s 28-9-109
Illinois	No	810 ILCS 5/9-109(d)(13)
Indiana	No	IND. CODE s 26-1-9.1-109
Iowa	Yes	IA CODE s 554.9109
Kansas	No	KAN. ST. ANN. 84-9-109(d)(15)
Kentucky	No	KY ST s 355.9-109(4)(q)
Louisiana	No	LA REV. ST s 9-109
Maine	Yes	ME ST t 11 s 9-1109
Maryland	Yes	MD COML LAW s 9-9109
Massachusetts	Yes	MA ST ch. 106s 9-109
Michigan	No	MI ST s 440.9109(4)(m)
Minnesota	Yes	MN ST s 336.9-109
Mississippi	No	MS CODE s 75-9-109(d)(13)
Missouri	No	MO St s 400.9-109(d)(14)
Montana	No	MT ST s 30-9-129(d)(m)
Nebraska	Yes	NEB. REV. STAT s 9-109
Nevada	No	NV ST s 104.9109 (4)(n)
New Hampshire	Yes	NH ST s 382-A:9-109
New Jersey	No	NJ REV. STAT. s 12A:9-109(d)(14)
New Mexico	No	NM STAT. ANN. S 55-09-109(d)(14)
New York	Yes	NY UCC LAW s 9-109
North Carolina	Yes	N.C. GEN. STAT. s 25-9-109
North Dakota	No	N.D. CENT. CODE s 41-09-09(4)(m)

Ohio	No	OHIO REV. CODE s 1309.109(D)(14)
Oklahoma	Yes	OK ST t 12A s 1-9-109
Oregon	Yes	OR REV. STAT. s 9-109
Pennsylvania	Yes	13 PA C.S.A. s 9109
Rhode Island	Yes	R.I. GEN. LAWS s 6A-9-109
South Carolina	No	SC CODE s 36-9-109
South Dakota	No	SD CODIFIED LAWS s 57A-9-109(d)(13)
Tennessee	Yes	TENN. CODE s 47-9-109
Texas	Yes	TX BUS & COM s 9.109
Utah	Yes	UT ST s 70A-9a-109
Vermont	No	VT STAT ANN. Ti 9A s 9-109(c)(14)
Virginia	Yes	VA CODE Ann. 8.9A-109(e)
Washington	No	WA REV. CODE s 62A.9A-109(d)(14)
West Virginia	No	WV Code s 46-9-109
Wisconsin	Yes	WI ST s 409.109
Wyoming	No	WY ST s 34.1-9-109(D)(xiv)

TABLE 2

STATES WHO HAVE ADOPTED 9-103(c)

[14 States] [1 Territory]

- ALABAMA
- ARKANSAS
- CONNECTICUT
- DELAWARE
- HAWAII
- IDAHO
- MINNESOTA
- MONTANA
- NEBRASKA
- NEVADA
- NEW MEXICO
- OKLAHOMA
- TEXAS
- U.S. VIRGIN ISLAND
- VIRGINIA

Answers

ACROSS

1.LAW 4.MORTGAGE 7. TN 8. DEBTORS 9. GA 10. LIEN 11. CONSIGNOR 15. AND 16. NJ 18.REJECT 22. NOTIFY 23. PMSI 25.SALE 26. FL 27. TOOL 28. TITLE 29. PRIORITY 31. AM 32.CONTROL 33.LESSOR 35. DC 38. DAKOTAS

DOWN

1. ATTACHMENT 3. CREDIT 5. RISK 6. ASSIGN 12. NAME 13. NINE 14. RA 17. JULY 19.COLLATERAL 20. UNIFORM 21. FIXTURES 24. MFG 29. PA 30. GOODS 33. LA 34. OIL 36.ID 37. ALASKA