

Revised Article 9 of the Uniform Commercial Code

May 24, 2001

Honorable James J. Lack
Chair, Senate Judiciary Committee
State Capitol, Rm. 413
Albany, NY 12247

Honorable Helene Weinstein
Chair, Assembly Judiciary Committee
Legislative Office Bldg., Rm. 831
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Dear Senator Lack: *
Dear Assemblywoman Weinstein:

This letter is to supplement our 2001 Report on Proposed Revised Article 9 of the UCC—Secured Transactions (hereinafter "2001 Report"), as well as our March 14 letter regarding various provisions of Revised Article 9. The discussion below addresses current UCC section 1-201(37), proposes a new section 9-710, and suggests several other technical changes in provisions of Revised Article 9.

1) UCC § 1-201(37) Definition of a Security Interest

As the result of an oversight, the language set forth below was omitted from Bill Draft 08992-04-1 on page 5. This language should be added to the end of UCC § 1-201(37):

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

- (a)** the original term of the lease is equal to or greater than the remaining economic life of the goods,
- (b)** the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
- (c)** the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
- (d)** the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that:

- (a)** the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
- (b)** the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

- (c) the lessee has an option to renew the lease or to become the owner of the goods,
- (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
- (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

For purposes of this subsection (37):

- (a) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;
- (b) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and
- (c) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

2) Revised UCC Article 9 Cooperative Provisions

As the result of discussion among the Commission, our Article 9 consultant, and the ad hoc group advising the Commission concerning the Article 9 cooperative provisions, we have concluded that several nonsubstantive changes would improve the clarity of Revised Article 9:

- a) In Section 9-102(a)(27-b), on page 27, line 28, the words "in this state" should be deleted, so that line would read "identified physical space belonging to the."

This change removes a statutory confusion that would otherwise result if the real property that is the subject of a cooperative organization straddles a state line.

- b) In Section 9-102(a)(44), on page 31, lines 14 and 15, the words "cooperative interests" should be deleted.

The exclusion of cooperative interests from the definition of goods is unnecessary. To the extent evidence of a cooperative interest is tangible, it is in the form of a stock certificate that is a species of investment property, which the Uniform text already excludes from the defined term "goods." Other aspects of cooperative interests are intangible rights, which cannot be goods.

- c) In Section 9-102(a)(73):

- (i) on page 38, line 19, the last word "which" should be deleted and replaced with the word "that";
- (ii) on page 38, line 23, the words "gives the cooperative organization" should be deleted. Substituted in their place should be the words, "states that the cooperative organization has";
- (iii) on page 38, line 24, the comma after the word "paid" should be deleted.

The changes recommended here deal with two distinct problems. The intent has always been to avoid a statutory requirement that magic words appear in the cooperative records in order to create a security in favor of the cooperative organization. The term "states" instead of "gives" accomplishes that goal slightly better. More importantly, documents of some older cooperatives purport to give to the cooperative the right to default. That remedy is probably unlawful and unenforceable. Nonetheless, the documents granting that remedy should be read to give the cooperative organization a security interest in the cooperator's cooperative interest. The word "states" would achieve the same result.

f) In section 9-109(d)(1), on page 49, line 5, the semi-colon at the end of the line should be removed and the words "or a security interest in a cooperative interest;" should be added.

There is little merit in a claim that a cooperative organization's security interest could be considered a "landlord's lien," and therefore excluded from Revised Article 9. Nonetheless, by making clear that a security interest in a cooperative interest is excluded from the term landlord's lien, the statute will prevent that argument from being made at all.

g) In Section 9-515(h), on page 144, line 7, the words "as an amendment" should be deleted so that the line reads "statement or is filed before the financing statement". The words "as an amendment" are surplusage, and could create unintended mischief.

h) In Section 9-516(e), on page 146, line 23, the words "as an amendment" should be deleted so that the line reads "notice. A filing that includes a cooperative addendum". The words "or is amended by" are surplusage.

i) In Section 9-522(a)(1)(B), on page 152, line 26, the word "indicates" should be deleted so that the line reads, "est, the real property tax designation associ-". The word "indicates" is surplusage.

3) Section 9-710. Special Transition Rule for Local Filing Offices.

States like New York that currently have dual state and local filing must provide for a graceful end to that duality as they move to statewide-only filing. The UCC enactment guide recognized this problem and proposed language upon which the provision set forth below is closely modeled.

Section 9-710. Transitional Provision for Maintaining and Searching Local Filing Office Records

(a) In this Section:

(1) /"Local-filing office" means a filing office, other than the department of state, that is designated as the proper place to file a financing statement under section 9-401 of former UCC Article 9. The term applies only with respect to a record that covers a type of collateral as to which the filing office is designated in that section as the proper place to file.

(2)"Former-Article-9 records" means:

(A) financing statements and other records that have been filed in a local-filing office before the effective date of this Article, and that are, or upon processing and indexing will be, reflected in the index maintained, as of the day before the effective date of this Article, by the local-filing office for financing statements and other records filed in the local-filing office before the effective date of this Article, and

(B) the index as of the day before the effective date of this Article.

The term does not include records presented to a local-filing office for filing after the effective date of this Article, whether or not the records relate to financing statements filed in the local-filing office before the effective date of this Article.

(3) "Cooperative interest", "mortgage", "as-extracted collateral", "fixture filing", "goods" and "fixtures" have the meanings set forth in this Article.

(b) A local-filing office must not accept for filing a record presented on or after the effective date of this Article, whether or not the record relates to a financing statement filed in the local-filing office before the effective date of this Article.

(c) Until at least seven years after the effective date of this Article, each local-filing office must maintain all former-Article-9 records in accordance with former Article 9. A former-Article-9 record that is not reflected on the index maintained on the day before the effective date of this Article by the local-filing office must be processed and indexed as soon as practicable but in any event no later than thirty days after the effective date of this Article.

(d) Until at least seven years after the effective date of this Article, each local-filing office must respond to requests for information with respect to former-Article-9 records relating to a debtor and issue certificates, in accordance with former Article 9. The fees charged for responding to requests for information relating to a debtor and issuing certificates with respect to former-Article-9 records must be the fees in effect under former Article 9 on the day before the effective date of this Article, unless a different fee is later determined in accordance with section ninety-six-a of the executive law.

(e) Seven years after the effective date of this Article, each local-filing office may remove and destroy, in accordance with any then applicable record retention law of this State, all former-Article-9 records, including the related index.

(f) This section does not apply, with respect to financing statements and other records, to a filing office in which mortgages or records of mortgages on real property are required to be filed or recorded, if:

(1) the collateral is timber to be cut or as-extracted collateral; or

(2) the record is or relates to a financing statement filed as a fixture filing and the collateral is goods that are or are to become fixtures; or

(3) the collateral is a cooperative interest.

4) Other Technical Changes:

Our review of the March 7, 2001 version of Revised Article 9 (Bill Draft 08992-04-01) has disclosed four non-substantive technical errors in need of correction:

1. On page 46, line 16, the term "letter-of-credit" should be changed to "letter of credit".
2. On page 203, line 10, the change in the cross-reference to Revised Article 9 is in error. The correct cross-reference to Revised Article 9 is 9-501.
3. On page 208, line 14, the change in the cross-reference to Revised Article 9 is in error. The correct cross-reference to Revised Article 9 is 9-109.
4. On page 212, line 9, the change in the cross-reference to Revised Article 9 is in error. The correct cross-reference to Revised Article 9 is 9-311.

The final Revised Article 9 issue on the Commission's agenda relates to sections 9-406 and 9-408. That issue is whether, and how, to save or nullify existing New York law that prohibits assignment or creation of a security interest. See 2001 Report at pp. 20-26. We have completed the required research, but the drafting process has proven somewhat more difficult than originally anticipated. Hopefully, we should have a recommendation in time for inclusion in Revised Article 9 even if a chapter amendment is required to do so.

Respectfully submitted,

Robert M. Pitler
RMP:ck

*Letter was sent under separate cover to Senator Lack and Assemblywoman Weinstein