YOUNG CONAWAY STARGATT & TAYLOR, LLP
Attorneys at Law

Summer 2010

Delaware Transactional & Corporate Law *Update*

The Proposed 2010 Revisions to UCC Article 9

by Norman M. Powell

Introduction. The current version of Article 9 ("Current Article 9") of the Uniform Commercial Code ("UCC"), as promulgated in 1998 by the Uniform Law Commissioners ("ULC") and The American Law Institute ("ALI"), has been enacted in all fifty states, the District of Columbia, and the U.S. Virgin Islands, and generally took effect on July 1, 2001. From 2008 to 2010, a committee (the "Review Committee") convened by the ULC and the ALI considered certain issues, ultimately recommending amendments to the official text of, and official comments to, Current Article 9 (the "2010 Amendments"). While most are unremarkable and simply clarify existing text, some are noteworthy. This article provides a summary and brief discussion of the 2010 Amendments. To the extent feasible, related provisions are discussed together regardless of their juxtaposition in the code. Unless otherwise noted, all citations in this article are to Current Article 9.

Summary. The 2010 Amendments were approved by the National Conference of Commissioners on Uniform State Laws at its 2010 annual meeting, and are now (or will shortly be) available for consideration and adoption. They include provisions that clarify, rather than change, what was intended by Current Article 9, as well as substantive changes reflecting emerged and emerging thought. Perhaps the most significant change is the offering of two alternative approaches to the vagaries of determining individual debtors' names. Alternative A, the so-called "only if" approach, would require that such names be rendered as they appear on a driver's license or other specified document. Alternative B, the so-called "safe harbor" approach, would merely create a safe harbor for financing statements naming debtors thus. Other debtor name changes are relevant where collateral is held by the personal representative of a decedent, and where collateral is held in a trust. The classification of certain entities as "registered organizations" is clarified, as is the record to be consulted to determine a registered organization's name. The current "four month rule" that continues perfection following a change in a debtor's location would be changed to provide not merely that a secured party's perfected security interest continues for four months following a change in its debtor's location (or, similarly, for four months following a new debtor becoming bound under an existing security agreement), but that such secured party is generally perfected in collateral acquired by its debtor within four months thereafter. The much-misunderstood "correction statement," which has no legal effect and can be filed only by a debtor, would be renamed an "information statement," would continue to have no legal effect, but could be filed by either a debtor or a secured party. The proposed changes would eliminate the requirement that financing statements indicate a debtor's type of organization, jurisdiction of organization, and organizational identification number, based on the judgment that the burden of providing such information outweighs the resulting benefits. These and the other revisions are discussed in more detail below.

Proposed Changes to Part 1: General Provisions.

Section 9-102(a)(7) – "authenticate": The 2010 Amendments begin with revisions to certain definitions. Section 9-102(a)(7) is revised such that the definition of "authenticate" more closely resembles the definitions of "sign" in revised UCC Articles 1 and 7. Recall that Current Article 9, intending to be medium-neutral, largely did away with

Meet the Author:

Norman M. Powell writes and speaks regularly at conferences and training programs on topics including alternative entities and secured transactions, and serves on the Commercial Financial Services, Legal Opinions, and Uniform Commercial Code Committees of the Business Law Section of the American Bar Association.

npowell@ycst.com
302.571.6629

anachronistic terms that suggested any requirement for paper documents and manual signatures affixed by humans wielding pens. This amendment is intended to bring to Article 9 the further-refined thinking of the years since the text of Current Article 9 was finalized in 1998.

Section 9-102(a)(10) – "certificate of title": Section 9-102(a)(10)'s definition of "certificate of title" is revised to comport with the emerging practice in many jurisdictions of maintaining non-paper electronic records evidencing both ownership and security interests. Conforming changes appear in Section 9-311 (Perfection of Security Interests in Property Subject to Certain Statutes, Regulations, and Treaties). The 2010 Amendments include a new sentence in Official Comment 5b to Section 9-102, noting that when electronic chattel paper is converted to tangible form ("papered-out," in industry parlance), tangible chattel paper results. In a similar vein, Official Comment 3 to Section 9-330 is modified to more clearly state that a secured party may achieve priority with respect to "hybrid" chattel paper (that is, chattel paper that is partly tangible and partly electronic chattel paper) under Section 9-330(a) or (b), and to clarify how a secured party can retain its priority when tangible chattel paper is converted to electronic chattel paper and vice versa.

Official Comment 5d to Section 9-102 – Assignment of Lessor Rights as Chattel Paper: Rejecting the holding in *In re Commercial Money Center, Inc.*, 350 B.R. 465 (B.A.P. 9th Cir. 2006), the 2010 Amendments provide in their changes to Official Comment 5d to Section 9-102 that if a lessor's rights under a lease constitute chattel paper, an assignment of the lessor's right to payment under the lease, even if the assignment excludes any other rights, would also be an assignment of chattel paper.

Section 9-102(a)(68) – "public organic record": Section 9-102(a)(68) is new, and brings specificity to the question of just what public record should be consulted to determine a registered organization's name. The new term "public organic record" generally means the document filed with or issued by the relevant state or the United States to form or organize a registered organization. Revisions to the accompanying Official Comment 11 explicitly indicate that a certificate of good standing is not a public organic record and, thus, not an appropriate referent for determining a registered organization's name. Similarly, the definition of "Registered organization" in (what will be renumbered as) Section 9-102(a)(71) is amended to clarify that the term includes organizations (i) formed or organized, (ii) by (a) the filing or issuance of a public organic record, or (b) by legislative enactment, even if such organizations are created without the need for a public organic record. These latter two provisions work in concert with revisions to Section 9-503 (discussed below).

Section 9-105 – Control of Electronic Chattel Paper: Section 9-105 is revised to provide a general test, and a safe harbor, for achieving perfection by control of electronic chattel paper. The language derives from the Uniform Electronic Transactions Act, and defers to emerging systems that reliably establish the secured party as the assignee of the chattel paper, contemplating continued innovation in this field generally.

Where is a debtor organized under federal law located? The 2010 Amendments clarify designation of a location for filing purposes.

Proposed Changes to Part 3: Perfection and Priority.

Section 9-301 – Law Governing Perfection and Priority: The 2010 Amendments include revision and augmentation of Official Comment 5b to Section 9-301 to clarify certain matters relevant to fixture filings and non-fixture filings against collateral of transmitting utilities. A security interest in most types of collateral, including fixtures, of a transmitting utility can be perfected by a central filing in the jurisdiction where the transmitting utility is located. But a fixture filing is effective to perfect a security interest only in fixtures of a transmitting utility located in the jurisdiction in which such fixture filing is made, with the consequence that multiple such filings may be required.

Section 9-307 – Location of Debtor: It is in Section 9-307 that Current Article 9 provides the rules for determining a debtor's location, and thus the place in which one must generally file a financing statement naming that debtor for such financing statement to be effective.[1] Its subsection (f) addresses the location of registered organizations organized under federal law. Subparagraph (f)(2) currently provides that where a location is designated in accordance with federal law, such location constitutes the organization's location for filing purposes. Alas, this succinct and seemingly clear provision has given rise to considerable consternation. In the parlance of many federal laws (e.g., the National Bank Act), what's designated is actually denominated a "main office" or "home office", not a location. In its initial enactment of Current Article 9, Delaware added to Section 9-307(f) non-uniform language to the effect that designating a main office or home office constitutes designation of a location. Revised versions of the Official Comments to Current Article 9 offered the same assurance,[2] but of course lacked the force of law. The 2010 Amendments would remove any doubt that such designations are, in fact, designations of a location for filing purposes.

Section 9-316 – Effect of Change in Governing Law: The 2010 Amendments significantly alter the effect of a change in governing law. Under Current Article 9 Section 316, perfection of security interests that have attached prior to a change in the debtor's location continues for four months after such change. The 2010 Amendments add a new subsection 316(h) pursuant to which a secured party would also enjoy perfection of security interests that attach within four months *after* a change in the debtor's location, provided it has already taken steps pursuant to which it would have been perfected absent the change in location. To illustrate, assume D is located in Florida and SP has

properly perfected its security interest in D's inventory and accounts receivable by filing a financing statement in Florida. Thereafter, D's location changes to Delaware. Under Current Article 9, SP remains perfected, for four months following the change in location, in any inventory and accounts receivable in which it was perfected *before* the

change. Under the 2010 Amendment, this remains so, but SP is *also* perfected in any (newly acquired) inventory and (newly arising) accounts receivable to which its security interest first attaches during the four months *after* the change in location. Such perfection continues until the end of this four-month period.

Similarly, a new subsection 316(i) provides for perfection of security interests that attach within four months after a new debtor becomes bound by an existing security agreement. Returning to our example, let's suppose that upon its "relocation" to Delaware "old D" is succeeded by "new D" as the debtor bound by the existing security agreement in favor of SP. Let us further suppose that "new D" enters into a financing transaction in which it grants SP2 a security interest in all of its inventory and accounts receivable, and that SP2 promptly perfects its security interest by filing in Delaware a financing statement naming "new D" as debtor. As between SP and SP2, both of whom have perfected security interests in inventory acquired and accounts receivable arising within the four months immediately following the change in location, who has greater priority? Current Article 9 Section 326 generally provides that, with respect to collateral in which the original debtor never held an interest, the security interest perfected by filing against the original debtor is subordinate to the security interest perfected by filing against the new debtor. The 2010 Amendments preserve and extend this result to the circumstances contemplated by new subsection 316(i). Thus, in our example, SP is subordinate to SP2 with respect to collateral in which "old D" never held an interest. A modest revision to Official Comment 2 to Section 9-326 clarifies the interplay between that section and tion 9-508 regarding subordination of certain security interests created by a new debtor.

Section 9-317 – Interests That Take Priority Over or Take Free of Security Interest or Agricultural Lien: In what is viewed as a clarification, the language of Section 9-317 is expanded to explicitly cover buyers of all types of collateral not susceptible to perfection by possession. Thus, a licensee of a general intangible, and a buyer (other than a secured party) of any collateral other than tangible chattel paper, tangible documents, good, instruments, or certificated securities takes free of a security interest if he gives value without knowledge of, and before perfection of, such interest.

Section 9-322 – Priorities Among Conflicting Security Interests in and Agricultural Liens on Same Collateral: In another clarification, Official Comment 4 to Section 9-322 has been augmented to include an explicit statement to the effect that a financing statement filed without authorization, but later authorized or ratified, thereupon becomes effective, but nevertheless enjoys priority from its time of filing. Official Comment 8 to the same section has been augmented to complete the explanation of certain priority rules applicable to proceeds: specifically, that where two security interests in the same original collateral are entitled to priority in proceeds under Section 9-322(c)(2), the security interest having priority in the original collateral has priority in the proceeds.

Proposed Changes to Part 4: Rights of Third Parties. Current Article 9 Section 406 is a broad override of contractual restrictions on assignability of receivables. Current Article 9 Section 408 is a narrow such override. The two differ on whether an assignee may enforce the assigned receivable against the account debtor or another obligor. The 2010 Amendments address the allocation of transactions between the broad override of Section 9-406 and the narrow override of Section 9-408, and have relevance where collateral is the right to payment of a loan. As they appear in Current Article 9, Sections 406 and 408 differ on whether an assignee may enforce the assigned receivable against the account debtor or another obligor notwithstanding a contractual restriction on assignability. If the right to payment is evidenced by chattel paper, it is clear the assignee can enforce the right despite any contractual restriction. But if the right to payment is evidenced by an instrument, or is a payment intangible, the assignee can enforce despite contractual restriction if the assignment is made for security, but not if the assignment is a sale. Experience has revealed uncertainty in determining whether foreclosure should be regarded as a "sale" or an assignment "for security." The 2010 Amendments clarify applicability of 9-406, and explicitly provide that a buyer at a foreclosure sale, as well as the assignee in a strict foreclosure under 9-620, can enforce the right notwithstanding any contractual restriction.

Perhaps the greatest and most significant of the 2010 Amendments appear in Section 9-503 (Name of Debtor and Secured Party).

Proposed Changes to Part 5: Filing. Perhaps the greatest and most significant of the 2010 Amendments appear in Section 9-503 (Name of Debtor and Secured Party). These changes are relevant to filings against registered organizations, filings where collateral is being administered by the personal representative of a decedent, filings where collateral is held in a trust that is not a registered organization, and, most significant of all, filings against individual debtors. With different variations in each context, it has proven challenging to determine exactly what a given debtor's name is, and likewise chal-

lenging to make other determinations antecedent to filling out financing statements and tendering them for filing. In addition to the changes discussed below, consistent changes appear in Official Comment 2 to Section 9-506 (Effect of Errors or Omissions).

Registered Organizations: It has proven unclear to some just which public record is relevant to determining the name of a registered organization. Many quickly came to the view that good standing certificates were not the appropriate source of such information, but uncertainty remained as to which filed, or issued, formation document should be consulted.[3] As revised by the 2010 Amendments, Section 9-503 refers to the "public organic record," the newly defined term appearing at new subsection 9-102(a)(68),[4] which means a record filed with the relevant state or the United States, and includes a charter issued by such state or the United States. Helpfully, it explicitly notes that a certificate of good standing or an index of domestic entities is irrelevant.[5] Moving beyond the challenge of determining a registered organization's name, the 2010 Amendments revisit the threshold question of what organizations fit the subcategory of registered organization. "Registered organization" includes an organization created without a public record but that is "formed" only when a public filing has been made. For example, a Delaware statutory trust is "created" by its governing instrument,[6] but is "formed at the time of the filing of the initial certificate of trust in the office of the Secretary of State . . . ."[7] Similarly, the 2010 Amendments clarify that a Massachusetts business trust is a registered organization.[8]

Decedents and Their Estates, Trusts and Trustees: The 2010 Amendments respond to some extent to difficulties experienced by those endeavoring to determine, in contexts involving decedents and their estates, and trusts and trustees acting with respect to property held in trust, the exact identity of the "debtor", which is to say the person possessed of the requisite rights to meet the statutory definition of "debtor" in Section 9-102(a)(28). In the former context, the 2010 Amendments eliminate the requirement that a filing indicate whether, in fact, the debtor is "a decedent's estate,"[9] and instead simply require indication that the collateral is "being administered by the personal representative of the decedent." In the latter context, the 2010 Amendments eliminate the requirement that a filing indicate whether, in fact, the debtor is "a trust" or, alternatively, is "a trustee acting with respect to property held in trust," and instead simply require indication that "the collateral is held in a trust." In both contexts, special transition rules provide, in effect, that financing statements filed prior to the effective date of the 2010 Amendments and meeting the then-current requirements (that is, the requirements of Current Article 9) in this regard will not cease to be effective by reason of their failure to provide the simpler (yet arguably different) indication required by the 2010 Amendments. The reader is cautioned, however, that although the challenge of determining the precise identity of the "debtor" need no longer be met as a precondition to properly filling out a financing statement, it remains vitally important inasmuch as the financing statement, to be effective, must generally be filed in the jurisdiction in which the debtor is located within the meaning of Section 9-307. Finally, it should be noted that the 2010 Revisions clarify that these special rules applicable to property held in a trust don't apply where collateral is held by a trust that is itself a registered organization – in such cases, the ordinary rules for filing against registered organization debtors should be followed.

Individual Debtor Names: The issue that presented the greatest challenge to the Review Committee was that of individual debtor names. Under Current Article 9, when the debtor is an individual, a financing statement is sufficient only if it provides the "name of the debtor." The simplicity of this requirement belies the challenge of its application. American law provides individuals nearly unlimited freedom to change their names, often with little or no formality or documentation. Consider, for example, the name changes that commonly accompany marriage and divorce, and the insidious spread of informality by which many a Thomas is known far and wide as Tom and many an Elizabeth as Liz (or, if personal preference so dictates, Beth), to say nothing of Stefani Joanne Angelina Germanotta (or is her name now "Lady Gaga?" And if so, is that a first name and surname, or something else?). While the Review Committee generally came to share the view that the simplicity of requiring the "name of the debtor," while appealing, presupposed that one could determine a debtor's name with greater certainty and ease than experience suggests one actually could, it found no panacea, and instead offers in the 2010 Amendments two alternative approaches. Alternative A – the

"only if" approach –requires use of the name that appears on the debtor's driver's license or other specified document (e.g., an identification card issued by his or her state of residence) or, if the debtor has no such document, the debtor's surname and first personal name. Alternative B – the "safe harbor" approach – retains the current "name of the debtor" approach, but also provides a "safe harbor" for using the name designated by statute (viz., the name appearing on the debtor's driver's license or state-issued identification card). These alternatives strike different balances in the allocation of risks and protections among filers and searchers. The "only if" approach appears very simple – if only the name on the relevant identification document will suffice, searchers need only conduct searches in such name. But this

approach is not without its limitations and shortcomings. If the relevant identification document expires, it is no longer a proper source for determining the debtor's name. One moves progressively down the waterfall of possible source documents or other indicia of individual names, any of which could

provide something different as the debtor's name. That is to say, a financing statement once perfectly featuring the debtor's name could cease to be effective upon expiration of a driver's license. Are secured parties prepared to monitor such developments, or to leave such matters to chance? The "safe harbor" is a viable, though by no means compelling, alternative. Its enactment may make it easier for secured parties to be and remain perfected, but it requires searchers to formulate a variety of queries (and aren't most people, by turns, both filers and searchers?). The 2010 Amendments leave it to the states to choose between these two alternatives.

Individual Debtor Names – Special Rule for Mortgages: The Review Committee recognized the very real possibility that people may continue to hold real estate in names that differ (at least to some extent) from their names as they appear on their driver's licenses. New subsection 502(c)(3)(B) recognizes that strict requirement of a debtor's "driver's license" name may not make sense in the context of real estate documents, and provides that use of the debtor's "individual name" or "surname and first personal name" suffice in the case of a mortgage effective as a financing statement. As explained in a legislative note to the 2010 Amendments, Section 9-502 should only be amended in states that adopt Alternative A – the "only if" approach – for naming individual debtors under Section 9-503, and is unnecessary in states that adopt Alternative B – the "safe harbor" approach.

Section 9-507 – Effect of Certain Events on Effectiveness of Financing Statement: Current Article 9 recognizes that debtors sometimes change their names, and that such changes can render existing financing statements seriously misleading and, thus, ineffective, unless appropriate amendments are filed. The Review Committee recognized that Current Article 9 subsection 507(c) focuses on behavior –"If a debtor so changes its name" - and in efforts to coordinate with the proposed revisions to Section 9-503 regarding individuals' names, shifts the focus to consequences – "the name that a filed financing statement provides for a debtor becomes insufficient . . . under Section 9-503(a)." That is, it recognizes that under the 2010 Amendments a debtor's name may change not only by reason of action on the part of the debtor, but also by reason of, for example, expiration of a driver's license .

Section 9-509 – Persons Entitled to File a Record: An amendment to Official Comment 6 to Section 9-509 is intended to clarify that authorization to file a record under Section 9-509(d) (that is, an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement) need not appear in an authenticated record. This stands in contrast with the requirement, that any authorization required under Section 9-509(a) (that is, in connection with an initial financing statement, an amendment that adds collateral covered by a financing statement, or an amendment that adds a debtor to a financing statement) must appear in an authenticated record.

Section 9-512 – Amendment of Financing Statement (new debtor or new name): Many have puzzled over Section 9-512 (Amendment of Financing Statement), and its requirements where a debtor undergoes a "conversion" under applicable state law. Many states permit "conversion" of one organization into another, but they differ (and some are simply unclear) as to whether the organization resulting from the conversion is the same legal person as the organization prior to conversion, or is a new organization. That is, it is sometimes unclear whether the debtor is the same organization, albeit with a different name (and perhaps a different type of organization, jurisdiction of organization, and organizational identification number), or is a different organization entirely. Current Article 9 defers to the law governing conversion for a determination as to whether the resulting organization is the same legal person as the original debtor, and the 2010 Amendments would make no change in that approach. New Official Comment 5 is intended to clarify and emphasize this deference. It explicitly provides that when such organizations are one and the same, an amendment reflecting the name (and any other) change should be filed, whereas when such organizations are separate and distinct, an amendment adding the resulting entity as a new debtor should be filed. Helpfully, the Official Comment offers that in the face of uncertainty, one would do well to follow both courses of action.

Section 9-515 - Evergreen Filings Against Transmitting Utilities: Recognizing a systems limitation present in many filing offices, Section 515(f) would be revised to require that in order to take advantage of the special rule that a financing statement naming a transmitting utility as debtor is effective until

terminated, the initial financing statement (as contrasted with an amendment thereto) must indicate such status. The similar rule, found in Section 515(b) and providing for 30 year effectiveness of financing statements relating to public-finance or manufactured-home transactions, has always required the requisite designation in the initial financing statement. Many filing offices simply can't revisit their initial coding of a financing statement to change its lapse date.

Section 9-521 – Uniform Form of Written Financing Statement and Amendment: In an effort to assist searchers in eliminating from concern filings that appear to relate to the debtors with which they are concerned but which, in fact, relate to other, identically or similarly named debtors, Current Article 9 provides that a financing statement can be rejected if it fails to state the debtor's type of organization, jurisdiction of organization, and organizational identification number (or an indication that it has none).[10] Of course, such information has little relevance except as applied to registered organizations, as to which filings are generally to be made in their jurisdiction of formation. But jurisdictions generally preclude the duplicative use of registered organization names and confusingly or deceptively similar names. The consequence is that the burden of providing such information was adjudged greater than any resulting benefit. The 2010 Amendments would eliminate any requirement for these three items of data. To implement these and other changes (e.g., those relating to debtors' names and other information, discussed above), the 2010 Amendments include new written financing statement forms, which will replace the forms appearing in Current Article 9 Section 9-521.

Section 9-518 – Claim Concerning Inaccurate or Wrongfully Filed Record: In a pernicious example of regrettable word choice, Current Article 9 gave rise to the so-called "correction statement." Conceptually, it was to be something akin to the statement an aggrieved debtor could send to the omnipotent consumer credit rating agencies to place "on record" a statement of disagreement with respect to an entry believed to be erroneous under the Fair Credit Reporting Act. The Article 9 correction statement is a mechanism by which a debtor can add to the public record an objection to, a statement that he or she never authorized, or other remarks concerning a given financing statement. As a matter of law, it can be filed only by a debtor, and has no legal effect whatsoever.[11] Despite the clarity with which these limitations are stated, not a few secured parties have purported to file correction statements, sometimes seeking to "undo" terminations filed in error.[12] In any event, the 2010 Amendments would rename these filings "information statements," and would permit both secured parties and debtors to file them. They would continue to have no legal effect, but nonetheless may prove helpful (for example, consider the secured party whose financing statement has not been terminated, but whose financing statement appears to have been terminated owing to the presence in the record of an erroneous termination statement filed by a rogue actor without authority).

Proposed Changes to Part 6: Default. The rules applicable following the occurrence of a default are being revised in three respects: nonjudicial enforcement of mortgages, public notice of electronic disposition of collateral, and prohibition of secured party's buying collateral in its private disposition.

Section 9-607 – Collection and Enforcement by Secured Party: As it appears in Current Article 9, Section 9-607(b)(2)(A) relates to nonjudicial enforcement of mortgages. It permits the secured party to record a copy of the relevant security agreement and a sworn affidavit with the mortgage records. This sworn statement must state that a default has occurred, but is less than explicit in indicating that such default must have occurred with respect to the obligation secured by the mortgage, as contrasted with some other obligation. For example, suppose Homeowner obtains a mortgage loan from Bailey Savings and Loan, which in turn sells the mortgage loan to Bear Stearns, which bundles it with others and sells interests in the pool through a securitization. If the securitization vehicle defaults, for example by failing to make a scheduled payment under the securities it issued, the holder of such securities would not be able to foreclose Homeowner's mortgage. This result, intended by Current Article 9, is more clearly mandated by the 2010 Amendments.

Section 9-613 – Contents and Form of Notification before Disposition of Collateral: General: There has been much consternation in recent years regarding notification of

a public disposition of collateral that will be conducted electronically. New text in Official Comment 2 to Section 9-613 (Contents and Form of Notification Before Disposition of Collateral: General) would confirm the applicability of such section to such dispositions, and clarify what information is required for compliance. Among other things, the 2010 Amendments clarify that a Uniform Resource Locator (URL) or other Internet address currently suffices as an electronic "location."

Section 9-624 – Waiver: Official Comment 2 to Section 9-624 (Waiver) notes that such section is a limited exception to the general rule of Section 9-602 prohibiting waiver by debtors and obligors. It explicitly notes that the rule prohibiting a secured party from buying at its own private disposition, the equivalent of a "strict foreclosure," cannot be waived. The 2010 Amendments would add language to similar effect to both Official Comment 3 to Section 9-602 and Official Comment 7 to Section 9-610. A new Official Comment 10 would be added to Section 9-611 (Notification Before Disposition of Collateral), reminding readers that enforcement of an Article 9 security interest may implicate other law.

Proposed Change to Part 7: **Transition.** The 2010 Amendments include the addition of text to Official Comment 2 to Section 9-706 (When Initial Financing Statement Suffices to Continue Effectiveness of Financing Statement), emphasizing that the

"minor error" rule in Section 9-506(a) applies to any initial financing statement filed as an "in lieu" continuation statement pursuant to Section 9-706.

Proposed (New) Part 8: Transition. When Current Article 9 was released for consideration and enactment, there was great interest in having a uniform effective date in all enacting jurisdictions. In furtherance of that goal, its text provided for a uniform effective date of July 1, 2001, roughly three years after its release. Similarly, the 2010 Amendments contemplate a July 1, 2013 effective date.[13] Generally, there's a five-year transition period before "old" filings made in conformity with Current Article 9 must be amended or otherwise revised to conform to the 2010 Amendments. The most significant transition issue, and the one likely to require the greatest number of amendments, involves sufficiency of debtors' names under Section 9-503, particularly those relating to individual debtors. Less common, but no less important, is the fact that certain debtors not currently but soon-to-be considered "registered organizations" may experience a change in location (i.e. from their place of business or chief executive office to their jurisdiction of formation).

Accompanying Revision to UCC Article 8 (Investment Securities): The 2010 Amendments would add a new paragraph to Official Comment 13 to UCC Article 8 (Investment Securities) Section 8-102 (Definitions). The paragraph addresses the registrability requirement in the definition of "registered form" and its parallel in the definition of "security," clarifying that such requirement is satisfied only if books are maintained for the purpose of register of transfer, including termination of rights under Section 8-207(a) (or, in the case of a certificated security, the security so states). Explicitly rejecting the holding of *Highland Capital Management LP v. Schneider*, 8 N.Y.3d 406 (2007), the comment notes it is not sufficient that the issuer record ownership or transfers for other purposes, nor is it sufficient that the issuer, though not in fact maintaining books for such purpose, theoretically could do so (for such is always the case).

Invitation to Repeal UCC Article 11: Finally, noting that UCC Article 11 affects transactions that were entered into before the effective date of the 1972 amendments to Article 9, the 2010 Amendments invite states to consider whether they may wish to repeal Article 11.

---

[1] The general rule is subject to exceptions, e.g. for fixture filings and for security interests in timber to be cut and as-extracted collateral. See 9-301 and Official Comment 5 thereto.

[2] *See* Official Comment 5 to 9-307, second paragraph.

[3] In a better world, of course, a registered entity's name would be rendered identically always and everywhere. The concern arises because many states maintain separate databases from which different documents and informational reports are generated. For a variety of reasons, including human error in data entry, programming or execution error in the transfer of data from one database to another, differing field length limitations, and differing protocols for the rendering of non-standard characters, it should be contemplated that the rendering of a registered organization's name may not always and everywhere be identical.

[4] See discussion above at Proposed Changes to Part 1: General Provisions

[5] *Id.*

[6] *See* 12 *Del. C.* § 3801(a)(1).

[7] 12 *Del. C.* § 3810(a)(2).

[8] *See, generally,* 2010 Amendments Section 102(a)(68) and (71), and Official Comment 11 thereto.

[9] Often, the "debtor" will be the personal representative of the decedent, not the estate itself. See 2010 Amendments, Section 9-503, Official Comment 2c.

[10] 9-516(b)(5)(C).

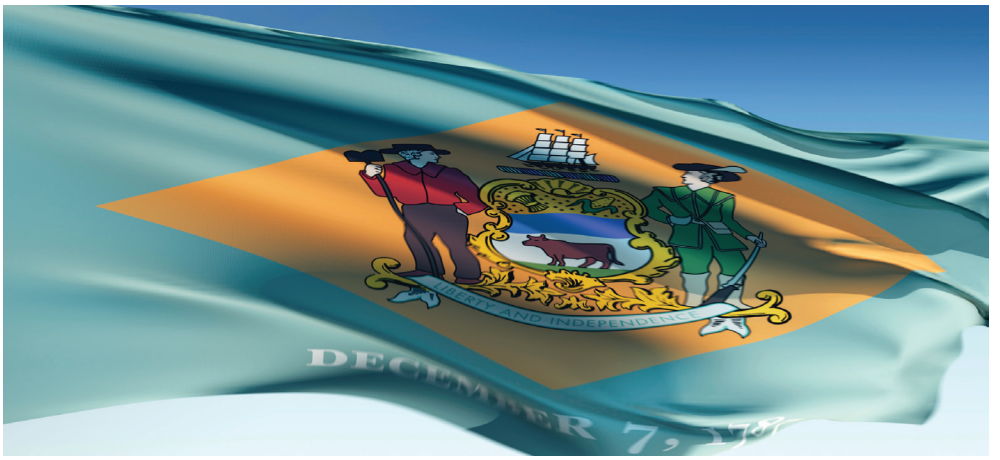
[11] *See* 9-518.

[12] A prominent example can be seen in Bank of America's filing of a correction statement in an attempt to fix its potentially $58 million filing mistake. Bank of America, acting for itself and as an agent of Citibank, terminated perfection of both institutions' security interests in certain assets of Heller Ehrman by accidently checking the "termination" box instead of the "continuation" box on the amendment it filed. As of this writing, the issue is being litigated in connection with the bankruptcy of Heller Ehrman LLP (See *In re: Heller Ehrman LLP,* Case No.: 08-32514 (N.D. Ca. March 27, 2009) *order granting Official committee of unsecured creditors' motion for order authorizing the creditors' committee to pursue certain estate causes of action* (currently pending in the U.S. Bankruptcy Court for the Northern District of California, San Francisco Division)).

[13] 2010 Amendments § 9-801.

2010 Amendments to the Delaware Limited Liability Company Act and Limited Partnership Act

by John J. Paschetto



In statutory amendments effective August 2, 2010, the Delaware legislature created for the first time a procedure by which Delaware limited liability companies ("LLCs") and limited partnerships ("LPs") can effect "short-form" mergers comparable to the "short-form" mergers that have been available to Delaware corporations in some measure since 1937. In addition, among other changes, the legislature established that LLC and LP agreements are not subject to the statute of frauds, clarified the circumstances under which a power of attorney given in connection with an LLC or LP may be irrevocable, and expanded the inspection rights available to members of an LLC or partners in an LP.

"Short-Form" Mergers

Section 253 of the General Corporation Law of Delaware (the "DGCL") has long afforded parent corporations the alternative of merging with one or more subsidiary corporations without a stockholder vote, if at least 90% of the outstanding voting stock of the subsidiary or subsidiaries is owned by the parent. This year, the Delaware legislature has amended the DGCL and the LLC and LP Acts to allow such mergers (a.k.a. "short-form" mergers) when the parent is an LLC, LP, or some other entity.

Under amendments to Section 18-209 of the LLC Act and Section 17-211 of the LP Act, a domestic LLC or LP that owns 90% or more of the outstanding voting stock of a corporation or corporations can merge the corporation or corporations into itself, or itself into one of the corporations, by authorizing the merger and adopting a "plan of merger" in accordance with its LLC or LP agreement and the LLC or LP Act, and filing a certificate of ownership and merger with the Delaware Secretary of State. A "plan of merger," according to the amendments, is "a writing approved by a domestic [LLC or LP], in the form of resolutions or otherwise, that states the terms and conditions of a merger under [the new 'short-form' provisions]." (6 *Del. C.* §§ 18-209(a) (LLCs), 17-211(a) (LPs).) If the LLC or LP does not own all of the outstanding stock of the corporation or corporations involved in the merger, the certificate of ownership and merger must state, among other things, how the stock not owned by the LLC or LP will be treated. In addition, such stock, if issued by a Delaware corporation, will have appraisal rights under Section 262 of the DGCL. (6 *Del. C.* §§ 18-209(i), 17-211(l).)

An advantage of the "short-form" merger procedure is that it allows the parent LLC or LP to merge with a 90-100% owned corporate subsidiary without obtaining the approval of the subsidiary's stockholders. When a "short-form" merger involves only corporations, approval by the parent's stockholders is also normally unnecessary, as long as the parent corporation is the survivor in the merger. (8 *Del. C.* § 253(a).) If, on the other hand, the parent is a Delaware LLC or LP, the plan of merger must be approved by the parent's members or partners as with any other merger, unless the LLC or LP agreement provides otherwise. (6 *Del. C.* §§ 18-209(b), 17-211(b).) Conforming amendments have been made to other sections of the LLC Act (§§ 18-203, 18-206, 18-210, 18-301, and 18-1105) and the LP Act (§§ 17-203, 17-204, 17-206, 17-212, 17-301, and 17-1107).

The Statute of Frauds

The Delaware Supreme Court held in December 2009 that the statute of frauds applies to LLC agreements. *Olson v. Halvorsen*, 986 A.2d 1150 (Del. 2009). As the court recognized, this was an issue of first impression — indeed, the trial court had been unable to find a case from any jurisdiction that addressed the question. The issue arose in *Olson* because the plaintiff-appellant argued that he was entitled to a multi-year payout following his ouster from an LLC, based on a written but unsigned LLC agreement. The defendants-appellees maintained, and both the trial court and the Supreme Court agreed, that the unsigned LLC agreement came within the applicable statute of frauds (6 *Del. C.* § 2714) because the payout provisions could not have been performed in less than one year. In addition, the Supreme Court also rejected the plaintiff-appellant's argument that the LLC Act impliedly repealed the statute of frauds insofar as it applied to LLC agreements. As court concluded, "[i]f the General Assembly intends to limit the application of the statute of frauds by removing LLC agreements from its scope, the General Assembly must say so, explicitly." *Olson*, 986 A.2d at 1162.

In view of the holding in *Olson*, the LLC and LP Acts have been amended to provide that LLC and LP agreements are "not subject to any statute of frauds (including [6 *Del. C.* § 2714])." (6 *Del. C.* §§ 18-101(7), 17-101(12).) This amendment is consistent with provisions of the LLC and LP Acts recognizing "written, oral or implied" LLC and LP agreements, and binding members and managers of LLCs and partners of LPs by the LLC or LP agreement even if they do not sign it. (6 *Del. C.* §§ 18-101(7), 17-101(12).) The amendment should provide additional certainty in a variety of contexts, such as when an LLC or LP is the survivor in a merger and, as a result of the merger, has new members or partners who might not sign the LLC or LP agreement for weeks or months, if ever.

Irrevocable Powers of Attorney

The 2010 amendments also provide additional certainty regarding the use of powers of attorney by LLCs and LPs. First, new subsections 18-106(d) and 17-106(d) confirm that, unless the LLC or LP agreement provides otherwise, an LLC or LP "has the power and authority to grant, hold or exercise a power of attorney, including an irrevocable power of attorney."

Second, under new subsections 18-204(c) and 17-204(c), for purposes of Delaware law, powers of attorney "with respect to matters relating to the organization, internal affairs or termination of [an LLC or LP] or granted by a person as a [member or partner] or an assignee of [an LLC or LP] interest or by a person seeking to become a [member or partner] or an assignee of [an LLC or LP] interest" are irrevocable if they state they are irrevocable and are coupled with an interest sufficient to support irrevocability.

Significantly, the amendments go on to state that powers of attorney as just described "shall be deemed" to be coupled with an interest sufficient to support irrevocability if they are granted to the LLC or LP; a member, manager, or partner; or an officer, director, manager, member, partner, trustee, employee, or agent of a member, manager, or partner that is itself an entity. In addition, such an irrevocable power of attorney, unless it states otherwise, will not be affected by any subsequent event concerning the principal, such as death, incapacity, dissolution, or bankruptcy. As a result, amended Sections 18-204 and 17-204 should give LLCs and LPs confidence in determining whether a power of attorney is irrevocable and in relying on irrevocable powers of attorney when executing documents or engaging in transactions.

Inspection Demands

The rights of members and managers of LLCs, and of partners of LPs, to obtain information regarding the affairs of an LLC or LP have been clarified in two important respects. Prior to the 2010 amendments, a member, manager, or partner was expressly entitled to seek judicial enforcement of inspection rights regarding only one of the six categories of information listed in the relevant statutory sections — i.e., the names and addresses of members, managers, or partners. As now amended, the subsections regarding judicial enforcement clearly pertain to all of the six categories of information, including the entity's financial condition, tax returns, and LLC or LP agreement; the amounts of capital contributions; and "[o]ther information regarding the affairs of the [LLC or LP] as is just and reasonable." (6 *Del. C.* § 18-305(a), (f); 6 *Del. C.* § 17-305(a), (e).)

The second significant amendment to inspection rights deals with the period of time within which an LLC or LP must respond to an inspection demand. As before, a member, manager, or partner demanding inspection may seek judicial enforcement if the LLC or LP does not respond to the demand within five business days. It is now clear that this five-day period may be decreased or increased in the LLC or LP agreement, although the period may not be made longer than thirty business days. (6 *Del. C.* §§ 18-305(f), 17-305(e).)

Amendments provide that LLC and LP agreements are "not subject to any statute of frauds[.]"

Choice of Law

A new subsection has been added to each Act to confirm that an LLC or LP agreement "that provides for the application of Delaware law shall be governed by and construed under the laws of the State of Delaware in accordance with its terms." (6 *Del. C.* §§ 18-1101(i), 17-1101(i).) In most circumstances, the application of Delaware law to the operating agreement of a Delaware LLC or LP would presumably follow from the "internal affairs doctrine" as articulated in such cases as *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1118 (Del. 2005), and *Facchina v. Malley*, C.A. No. 783-N, 2006 Del. Ch. LEXIS 142, at *13 (Del. Ch. Aug. 1, 2006). However, given the strongly contractual nature of LLC and LP agreements, and the almost limitless range of subject matter they may address, there remained the possibility that a court could apply a conflict-of-laws analysis to such an agreement, even if it expressly selected Delaware law.

The 2010 amendments remove uncertainty in this regard when Delaware law is selected. At the same time, the amendments are not intended to create new uncertainty as to Delaware LLC and LP agreements that have not expressly selected Delaware law. As explained in the legislative synopses accompanying the amendments, they are "not intended to negate the application of Delaware law to the interpretation and enforcement of [an LLC or LP] agreement that does not explicitly provide for the application of Delaware law or to negate the application of the internal affairs doctrine to Delaware [LLCs or LPs]." (Del. H.B. 372 syn., 145th Gen. Assem. (2010) (amendments to LLC Act); Del. H.B. 373 syn., 145th Gen. Assem. (2010) (amendments to LP Act).)

Service of Process on the Secretary of State

The sections of the LLC and LP Acts dealing with service of process have been amended to enable the Delaware Secretary of State to issue rules regarding service of process on him "by means of electronic transmission[.]" (6 *Del. C.* §§ 18-105(b), 17-105(b).) Previously, when the Secretary of State was served with process, "a copy" of the process had to be served in the same manner that was (and continues to be) required for valid service on an LLC or LP itself or its registered agent. (6 *Del. C.* §§ 18-105, 17-105.) Now the Secretary of State is authorized to accept electronic service, but only in accordance with such rules and regulations as he may adopt. Practitioners should therefore check the Secretary of State's website to determine the content of the applicable rules and regulations when they are adopted.

Amendments have also been made to permit the Secretary of State to use a "courier

service[,]" and not just certified mail, when notifying an LLC or LP that the Secretary of State has been served with process directed against the entity. (6 *Del. C.* §§ 18-105(b), 17-105(b).) Conforming amendments regarding service of process have been made to Sections 18-209, 18-213, 18-216, 18-910, and 18-911 of the LLC Act, and to Sections 17-211, 17-216, 17-219, 17-910, and 17-911 of the LP Act.

Other Amendments

Sections 18-704 of the LLC Act and 17-702 of the LP Act have been amended to confirm that an LLC or LP agreement may vary the default provision that the assignee of an LLC or LP interest is admitted as a member or limited partner if admission is approved by all members or partners. A similar amendment has been made to Section 18-702 of the LLC Act, regarding the circumstances under which an assignee is afforded the right to participate in the management of an LLC.

Finally, a new requirement has been introduced with respect to foreign LLCs and LPs registering to do business in Delaware. In addition to submitting a signed application for registration and paying the statutory fee, the foreign entity must now also provide a certificate "of its formation evidencing its existence" and dated within the preceding six months. If the certificate is not in English, a translation under oath must also be provided. (6 *Del. C.* §§ 18-902(2), 17-902(2).)

About the Update:

The Delaware Transactional & Corporate Law Update is published by the Business Planning and Transactions section of Young Conaway Stargatt & Taylor, LLP.

Young Conaway, based in Wilmington, Delaware, is among the state's largest law firms, with over 100 attorneys in 10 practice sections that include bankruptcy, corporate, intellectual property, employment law, tax, banking and real estate practices.

The Business Planning and Transactions section handles matters arising at every stage in the formation, growth and development of corporations, limited liability companies, limited partnerships, statutory trusts and other types of entitites, including those formed as special purpose entities in securitization and other structured transactions. The section's attorneys combine experience in Delaware corporate law, alternative-entity law, tax, commercial transactions and bankruptcy reorganizations.

To receive a complimentary subscription to this publication, please send an e-mail with your contact information to info@ycst.com or visit our web site at www.YoungConaway.com. To opt out of an e-mail subscription, please send your name and e-mail address with "unsubscribe to bpt newsletter" in the subject line to info@ycst.com.

Members of the Business Planning and Transactions Section

Craig D. Grear, Partner. Mr. Grear has made numerous presentations nationally and internationally on a variety of Delaware business law topics, including alternative entities and Delaware holding companies. He is a 1989 graduate of Georgetown University Law Center.

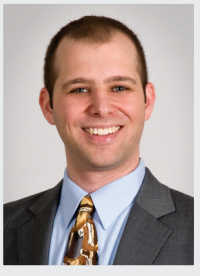
cgrear@ycst.com
302.571.6612

James P. Hughes, Jr., Partner. Mr. Hughes has litigated numerous matters in the Delaware Court of Chancery and served as in-house counsel at an Internet company. He is a 1992 graduate of the University of Pennsylvania Law School.

jhughes@ycst.com
302.571.6670

John J. Paschetto, Partner. Mr. Paschetto has contributed to several books on corporate takeovers and the limitation of director liability. He is a 1998 graduate of Harvard Law School.

jpaschetto@ycst.com
302.571.6608



Evangelos ("Andy") Kostoulas, Associate. Mr. Kostoulas practices primarily in the commercial transactions area with a focus on mergers and acquisitions, the structure and use of Delaware entities, and the rendering of legal opinions. He is a 2007 graduate of the University of Pennsylvania Law School.

ekostoulas@ycst.com
302.576.3589