

Successfully Managing UCC Filings in a World of Non-Uniformity

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Merriam-Webster's Dictionary defines *uniform* as, "of the same form with others: conforming to one rule or mode." It's not known whether the U.S. Congress consulted Merriam-Webster's when it first published the Uniform Commercial Code (UCC) in 1952; however, the intent was to harmonize the often confusing myriad of state codes governing commercial activity into one easy-to-understand, *uniform* law.

The intent was certainly noble. But the outcome did not quite result in the desired conformity across the states. Yes, while the "U" in UCC stands for uniform, filing and managing UCC statements are anything but uniform. Whether considering a single debtor or a multi-billion dollar transaction involving mammoth banks, the landscape is fraught with risk from even the slightest misstep, and there seems to be no common – or uniform – way to feel completely protected.

UCC forms are critical to a number of financial processes and several key distinctions and nuances can greatly affect your UCC standing. As a result, there are plenty of reasons to be concerned about UCCs these days. Whether faced with the prospect of increasing interest rates, rollbacks of regulations designed to protect consumers or even difficulty in confirming identity of a debtor, the modern financial landscape is littered with potholes that can trip you up if you're not careful.

Incomplete or inaccurate forms affect both notice and financial priority, and an error as simple as an unintended extra space can render the document completely unusable.

The world of finance is fast moving, but fortunately there are ways to avoid disaster. By keeping an eye on certain guideposts, you can emerge from the chaos (relatively) unscathed.

Debtor and UCC Monitoring

Like a nagging pain behind your eyes, making sure your loan is secure is the undisputed "headache" of UCC life for most secured parties. A lender simply has to know what's going on with the parties to whom they have loaned money.

Monitoring of debtors, is one way to ensure transparency of activity. While a difficult task to achieve in a do-it-yourself environment, there are plenty of opportunities to partner with specialists that can put together a program to conduct debtor due diligence.

Monitoring has its advantages. In particular, it can alert you if someone is trying to negatively impact your rights, when a debtor trying to pledge collateral to other parties or if you have terminated a filing by accident. However, there are always limits, even with monitoring. For example, a debtor can start a brand-new business entity that isn't being monitored, or can re-incorporate an existing business in another state. Different systems in different states still struggle to communicate with one another and there are many cases of debtors simply packing up and moving down the road to start again. And this is only taking into account single parties.

Another issue not to be overlooked: Debtor mergers and acquisitions (M&As) and a new name are materially different. In a typical M&A scenario, the acquiring entity becomes the holder of all the acquired company's liens. It's up to the acquiring organization to make sure they are aware of, and conduct due diligence on, the liens they picked up in the merger. When a company simply takes a new name, however, the lien holder must be sure to track the debtor and make adjustments to the filing and account for its new name.

It quickly becomes obvious there's an enormous amount of information to track and ensure it is correct. Where can a conscientious lender turn for help? Surely the individual states provide data to help monitor, right?

Well, no.

The states do not monitor for you at all — period! They file and maintain records. That's it. It's not the job of the state to keep track of your filings. The burden remains squarely on the back of the lender. And with that burden comes tremendous risk.

The lack of uniformity across systems is part of the problem. Few states have modern databases that can help you file and monitor UCCs. Remember, even if a party submits their filing electronically, a state employee is entering information into that system manually. That means, believe it or not, they can (and do) get it wrong.

What Happens When You Get It “Wrong”

When it comes to “naming wrongs,” consider the case of *Ronald Markt Nay v. Leaf Capital Funding, LLC* (U.S. Bankruptcy Court for the Southern District of Indiana). MainSource Bank (MainSource) filed a financing statement against Ronald Markt Nay (debtor) on Feb. 4, 2014. The financing statement was a blanket lien, and was filed against the individual debtor name “Ronald Markt Nay.”

LEAF Capital Funding (LEAF) made a loan to the debtor to finance the purchase of a Terex TA400 Dump Wagon (a brand of high-capacity dump truck). The lender diligently filed a financing statement on Dec. 21, 2015. LEAF made a second loan to the debtor to finance the purchase of the Terex 3066C Dump Wagon, and filed a financing statement for that loan on Dec. 10, 2015.

Each of the LEAF financing statements identified the debtor's name as "Ronald *Mark* Nay," while the debtor's actual name listed on his most-recently issued, unexpired Indiana driver's license is "Ronald *Markt* Nay." There is but a single letter difference in the names; however, that difference will prove crucial... and costly. Nay and his wife, Sherry L. Nay, filed a Chapter 11 bankruptcy on May 13, 2016.

Indiana has adopted the 2010 Amendments to Article 9 of the UCC. These amendments include an important provision stating that a financing statement sufficiently provides the debtor's name only if it provides the "full, correct" name of the individual as indicated on their driver's license. As noted above, LEAF's statements did not, as there was a subtle difference in the spelling between the debtor name statement and the one on driver's license.

That difference brought a key question to the forefront: Is using an alternate name permissible when conducting a UCC search? LEAF claimed that an Indiana filing office administrative rule permitted searches on variations of the debtor's "full, correct name." MainSource contended that alternative names are not permitted, as the statute itself provides that the "full, correct name" of the debtor is the name as it appears on his or her Indiana driver's license. The court agreed with MainSource.

The court explained that, under Section 9-506, the variation of a debtor name on the financing statement is not considered seriously misleading if it is uncovered during a search of the full, correct name using the filing office's standard search logic and while searching the filing office's official records. In this case, the filings containing the name variant were not found when a search of the correct name was made, and thus the filings are legally ineffective.

The court found that the security interests of LEAF Capital Funding were unperfected (or unsecured), meaning their place in the line of secured lenders was not guaranteed. MainSource Bank, not LEAF, held the first priority lien against the collateral. In other words, MainSource got to recover the debtor's collateral before LEAF. LEAF, therefore, might have to settle for significantly less, if it gets anything by the time the secured lender is satisfied.

Helpful Reminders

It's imperative that the full, correct debtor name (as provided in Section 9-503 of Article 9 of the UCC) be used at all times when filing financing statements or searching a debtor name in the UCC index. Close attention must be paid to individual names, as a majority of states now mandate the use of the individual debtor name as it appears on the state-issued driver's license.

You can't make it the debtor's problem, either. While there are situations where a lender can require contractual obligations for the debtor to be responsible for alerts to changes, some debtors forget such matters – or, believe it or not, they lie.

Always remember that when taking into account all 50 states, the UCC is rarely “uniform”. The varying requirements from state to state always require your complete attention to detail.

Search-to-Reflect

There is, however, one important aid for monitoring: a Search-to-Reflect (STR). An STR provides early assurance that the UCC filing will be found in the public record under the exact, true and correct debtor name. An STR can be considered cheap insurance and can determine if you were properly filed in the first place and if not, was it your error or the state’s. It can also further validate your position to collect. Most seasoned UCC pundits agree that an STR is a critical component of any strong due diligence process

If the lender is in error, an STR can provide time to get it fixed before other secure parties appear on the system. An STR can also show if there has been any other activity on the targeted filing.

A good monitoring program will protect against other concerns as well, such as a debtor trying to pledge your collateral to another secured party, a debtor acquiring new debts to different secured party (filed jurisdictions) and a corporate debtor incorporating as a new entity in current jurisdiction or a new state.

The moral of the story – even though tracking debtor might seem like a giant headache, a strong lien-monitoring program is, in reality, a simple to implement with the right partner and a sure-fire way to protect your interests.

Mergers & Acquisitions

The year 2016 saw corporate mergers worth \$642 billion, down only slightly from the record year of 2015, when \$786 billion in mergers took place. There’s extraordinary activity in the corporate M&A world.

M&As involve nearly every kind of financial institution and come in all sizes. The market forces driving this activity seems just as varied: There are market-entry acquisitions by small banks, market-expansion plays by large banks, new market investments by foreign companies, and a plethora of private-equity investment.

These transactions affect more than just companies, buildings and employees. An incredible number of UCC filings and/or financing statements are involved as well. Those filings represent a significant portion of any financial institution’s backbone. After an M&A, the acquiring bank or financial institution should be asking, “What do we do with these UCCs from the [acquired] bank?”

At first glance, it might seem there's little to be done. The code itself suggests that not much is legally required. The secured party is under no obligation to change UCC documents after a merger or acquisition.

Therefore, the "new" secured party (the acquiring institution) doesn't have to do anything until the UCC document's life is up. That's what the law says, but what can happen in the real world?

There's a significant risk for the bank or financial institution when determining whether the new situation is simply a UCC assignment or complete change of place in priority line. Depending on the jurisdiction, collateral and the number of secured parties seeking restitution, the circumstances can be, at best, inconsistent and at worst, wildly unpredictable.

Among all the variables, perhaps the biggest cause for concern is a Purchase Money Security Interest (PMSI). If one exists from another lender and a notice is sent to the old bank or its address before your merger with it, it can be argued that the other lender's duties were met. That can mean you, the new institution following the merger, are without recourse when you are "jumped" in the line of secured lenders. The same is true if a bankruptcy trustee sends notice to the acquired bank instead of the new one. The new bank is at risk of receiving no notice and could lose their place in line to collect.

The best practice is to move any and all UCCs from the "old" financial institution's name into that of the acquiring institution. Is it a simple process? No, it's not. But it could end up helping you protect assets that otherwise could be at risk.

Yes, it can be a daunting task to move so many UCCs. However, there's no need to go it alone. The right partner can manage the process and ensure all documentation is properly worded, named and filed. The alternative is needlessly putting millions – or billions – of dollars' worth of loans at risk.

Charter Documents are Your Best Friend

Determining the exact legal name of a party is one of the most common problems with UCC filings. Changes in the code in 2013 have altered the process in determining the correct debtor name.

In most cases, financing statements apply to businesses. Use the organic public record to find the exact legal name of the debtor. The only sufficient document is the most recent charter document where the business is registered. This will usually be the *Articles of Incorporation* or *Articles of Organization*.

Relying on the *Certificate of Good Standing* for the correct debtor name is no longer an option. Such information is deemed "compiled data" – information that has been manually entered into a system. Therefore it's assumed the information could have been entered incorrectly.

It's now become necessary to follow the Organic Public Record Rule. Organic, in this case, means the original record as filed by the organization or company itself with the state or federal government, not simply compiled data entered by someone else.

Due to the Organic Public Record Rule, you will need a copy of the organization's most recent charter documents for UCC filings. It can often seem that the rule greatly complicates a lender's life, but the rule is meant to help UCC filings avoid using potentially erroneous compiled data.

Relying on any other type of state document is not the equivalent of using charter documents. *Certificates of Good Standing* or name listings from a secretary of state's website can't be relied upon due to their status as compiled data. You can't just print the screen of a secretary of state's website and feel satisfied you are getting the correct information for your UCC filing.

When filing, pay careful attention to whether a company has a DBA or FKA as part of its name - those should not be included. Instead, list the DBA as a separate debtor in order to include all possible names. You may also elect to leave the DBA information off the UCC entirely to avoid confusion.

Common sense and a little bit of extra work will keep the law on your side when there is an issue with a lien.

- Don't rely on your client's original charter documents - these are quite often not the most recent version.
- Get the most recent copy of the charter documents from the secretary of state's office (these are easy to order) - don't just hit "print screen."
- You don't need a certified copy (which requires an extra cost) of the charter documents. However, if the matter is for an extremely important transaction, or you perceive issues with parties, it may not be a bad extra level of protection

Yes, as seen throughout this document, the process of filing and managing UCC statements are anything but uniform. From loans to a single debtor to a multi-billion dollar transaction involving mammoth banks, it's a landscape fraught with risk from even the slightest misstep.

Fortunately, just a little bit of extra due diligence goes a long way. And in places where you feel you aren't the expert, there are helpful faces that can assist with lien monitoring, renewal, transfer of holder and all of the other variables that exist.

If nothing else, it's important to remain diligent and leave nothing to chance. Whether alone or with a partner, you need to always remain aware of the changes that every new day brings in the world of UCC.

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