REPORT
ON THE
UNIFORM COMMERCIAL CODE MODERNIZATION ACT OF
2001

Prepared by
The Article 9 Task Force
of
The Business Law Section
of
The Pennsylvania Bar Association

To Accompany
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* By the National Conference of Commissioners on Uniform State Laws.
I. INTRODUCTION

A. Overview and Background. In 1999 the joint sponsors of the Uniform Commercial Code (“UCC”), the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) and the American Law Institute (“ALI”), promulgated a comprehensive revision of Article 9 of the UCC. That revision package, which includes conforming changes to other Articles of the UCC, is referred to in this report as “Revised Article 9.” The proposed Uniform Commercial Code Modernization Act (the “Act”) enacts Revised Article 9 as Pennsylvania law.

The Act enacts Revised Article 9 with only a few minor substantive changes to the Official Text of Revised Article 9 as promulgated by NCCUSL-ALI. The most significant nonuniform change pertains to filing fees, discussed in part III of this report; other nonuniform changes are identified in part VI of this report. In addition to enacting Revised Article 9, the Act updates the provisions of Pennsylvania’s four certificate of title laws as they relate to secured transactions, corrects minor errors in Pennsylvania’s enactment of the UCC, repeals certain obsolete Pennsylvania laws relating to security interests in personal property, and makes other conforming changes. Finally, the Act also enacts as Pennsylvania law the 1995 revision of Article 5 of the UCC, pertaining to letters of credit.

Article 9 of the UCC governs transactions in which a debtor grants to a creditor a security interest in personal property (that is, property other than real estate). As such, it is arguably the most important single piece of commercial legislation in force in Pennsylvania. Trillions of dollars of credit secured by personal property are outstanding to commercial and consumer borrowers. Article 9 is the basic law that governs those secured transactions.

Article 9 has been in force in Pennsylvania since 1953, when Pennsylvania became the first state to enact the UCC. Pennsylvania amended its enactment of Article 9 in 1959 and 1963 to adopt teething changes made in the Official Text of the UCC through 1962. A final set of teething changes to the Official Text of Article 9 was made in 1972, and Pennsylvania enacted those 1972 revisions in 1982, Pennsylvania having in the meantime reenacted the UCC without substantive change as Title 13 of the

1 The Official Text of Revised Article 9, referred to herein as the "1999 Official Text," is dated March 8, 1999, supplemented by official errata and amendments issued on various dates through and including March 3, 2000.

In this report, "Revised Article 9" is used to refer both to the 1999 Official Text of Article 9 and to the Pennsylvania enactment thereof effected by the Act. “Existing Article 9” is used to refer both to the 1995 Official Text of Article 9 and to the current Pennsylvania enactment of Article 9 (which is substantively identical to the 1995 Official Text except for the few differences identified in part III of this report). In this report, section citations are to the existing or proposed Pennsylvania enactment (e.g., “Existing 9-306”), unless identified as being to the Official Text (e.g., “the Official Text of Existing 9-306”). Section numbers are hyphenated in the Official Text but are not hyphenated in the existing or proposed Pennsylvania enactments. In the Official Text, “Article 9” is divided into “Parts” and “Subparts”; under Pennsylvania drafting conventions the equivalent divisions are “Division 9,” “Chapters” and “Subchapters”. For simplicity this report generally uses the terminology of the Official Text (e.g., “Article 9”) even when referring to the existing or proposed Pennsylvania enactment.

2 Act of April 6, 1953, P.L. 3, No. 1, the effective date of which was July 1, 1954.

3 Act of October 2, 1959, P.L. 1023, No. 426 (reenacting the UCC, with amendments, to conform to the 1956 Official Text); Act of August 24, 1963, P.L. 1213, No. 519 (amending various Articles, including Article 9, to conform to the 1962 Official Text). William A. Schnader, Pennsylvania and the Uniform Commercial Code, 37 TEMPLE L.Q. 265 (1964), chronicles Pennsylvania’s experience with the UCC through 1964. Mr. Schnader, a prominent member of the Pennsylvania bar, was the driving force behind the original UCC project nationwide.
Pennsylvania Consolidated Statutes. The Official Text of Article 9 has not been otherwise amended since the 1972 revisions, except for changes made to conform to revisions to other Articles of the UCC. Aside from conforming changes, Pennsylvania has made only a single amendment to its enactment of Article 9 since the adoption of the 1972 Official Text in 1982.

When the UCC was first promulgated in 1952, Article 9 was perhaps its most novel feature. Before the UCC there was no single body of law that governed liens in personal property. Instead, in each state a confusing patchwork of different statutes and common law doctrines applied to such liens, depending on the specific type of property and other variables. Those laws differed markedly from state to state. Article 9 replaced that nonuniform patchwork with a single uniform statute applicable to almost all types of personal property. Article 9 has been an enormous success, adopted by every state in the Union, and is perhaps the most successful of any of the uniform laws promulgated during the hundred-plus years of NCCUSL’s existence. But the world has not stood still in the fifty-odd years since Article 9 was first drafted, or in the thirty-odd years since the 1972 revisions. It has become apparent that a comprehensive overhaul is necessary in order to assure that Article 9 will work as well in the 21st Century as it did during the last half of the 20th.

The project to revise the Official Text of Article 9 began in 1990, when the Permanent Editorial Board for the UCC established a study group of distinguished scholars and practitioners to evaluate the desirability of such a revision. The study group published a 250 page report in 1992. The report concluded that Article 9 was fundamentally sound, but recommended that serious consideration should be given to numerous incremental revisions.

The Permanent Editorial Board implemented that recommendation in 1993 by appointing an equally distinguished drafting committee to revise the Official Text of Article 9. The drafting committee met fifteen times from 1993 to 1998, in open sessions that were attended by many interested parties, academics and practitioners. Successive drafts of the revision were posted on the Internet.

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5 This “single amendment” was the brief Act of July 1, 1983, P.L. 29, No. 17, the main feature of which was a nonuniform change relating to security interests granted by governments and governmental agencies. That change is discussed in part IV.B of this report in connection with Existing 9104(5). Conforming amendments to Pennsylvania’s enactment of Article 9 in connection with revisions of other Articles of the UCC were made in 1992 as part of Pennsylvania’s adoption of the 1978 Official Text of Article 8 and the 1990 Official Text of Articles 3 and 4 (Act of July 9, 1992, P.L. 507, No. 97), and in 1996 as part of Pennsylvania’s adoption of the 1994 Official Text of Article 8 (Act of May 22, 1996, P.L. 248, No. 44). Minor conforming changes to Article 9 were also made in the General Association Act of 1998 (Act of December 21, 1988, P.L. 1444, No. 177), and the GAA Amendments Act of 1990 (Act of December 19, 1990, P.L. 834, No. 198).


7 Among the many groups represented at meetings of the national drafting committee were the American Bankers Association, the Association of Commercial Finance Attorneys, the Commercial Finance Association, the Commercial Law League, Consumers Union, the National Consumer Law Center and various national and state bar associations.
were summarized in mass mailings to members of the American Bar Association. The drafts were
discussed and debated numerous times at the annual meetings of NCCUSL and ALI, and were the subject
of extensive public discussion at meetings of bar associations, trade associations and the like during
the course of the drafting process. The process culminated in a final text of Revised Article 9 that was
unanimously approved by NCCUSL and ALI in 1998. The American Bar Association approved the final
text at its 1999 mid-year meeting. The Official Text of Revised Article 9 is formally dated 1999, due to
minor technical corrections made to its massive text in that year (which continued until early 2000).

B. Enactment Status Nationwide. As of April 2001, Revised Article 9 has been
enacted by 35 states and the District of Columbia, and bills to enact it have been introduced in each of the
other 15 states.

C. Reasons for Enacting Revised Article 9; Uniform Effective Date. Revised
Article 9 rewrites and reorganizes Existing Article 9 in its entirety, and makes many substantive changes.
However, those changes are not radical. Nor do they reflect only one or a few guiding themes. Rather,
the revision is a pervasive fine-tuning of Existing Article 9.

Appendices A and B to this report reproduce two publications by NCCUSL that
respectively summarize the principal reasons for states to enact Revised Article 9 and the principal
substantive changes it makes to Existing Article 9.

It is vital that Revised Article 9 become effective in Pennsylvania on July 1, 2001, the
uniform effective date built into the Official Text of Revised Article 9. One reason why a uniform
effective date is important is because Revised Article 9 significantly alters the system maintained by each
state for filing public notice of security interests. If most states enact Revised Article 9 in a timely way
but Pennsylvania does not, it might be impossible to determine with certainty the state in which it is
necessary to file in order to perfect a security interest against a debtor having ties to Pennsylvania. That
would impose substantial and wasteful costs on lenders (and hence on borrowers), because lenders are
likely to take the position that they must file in every conceivable jurisdiction in which a filing might be
necessary under either Existing or Revised Article 9. A second reason follows from the fact the revision
broadens the scope of Article 9. If most but not all states adopt the revision, a secured party might be at
risk if it takes a security interest that is covered by Revised Article 9 but not Existing Article 9. Even if
the debtor and secured party are both located in a Revised state, and even if the documentation for the
secured credit is governed by the law of a Revised state, if the debtor files for bankruptcy it might well be
able to establish venue in an Existing state, and in that event a bankruptcy court sitting in that state
arguably might be compelled to apply the Existing version. The result may be to wipe out the security
interest. Hence if any significant number of states fail to enact the revision, a secured party’s practical
ability to rely on the revision even in a state that has enacted it may be severely impaired.

D. Enactment of Revised Article 5 in Pennsylvania. In addition to Revised Article 9,
the Act will enact as Pennsylvania law the 1995 Official Text of Article 5 of the UCC, pertaining to
letters of credit, together with conforming changes to other Articles (“Revised Article 5”). After
NCCUSL-ALI promulgated the 1995 revisions to Article 5, the Business Law Section (then named the
Section on Corporation, Banking and Business Law) of the Pennsylvania Bar Association appointed a
task force (the “Pennsylvania Article 5 Committee”) to study and report on the revisions and, if they
deemed it appropriate, to draft legislation to enact those revisions. The Pennsylvania Article 5
Committee, in consultation with the Legislative Reference Bureau, accordingly drafted a bill (S.B. 805 of
the Session of 1999), to enact Revised Article 5 as Pennsylvania law. The Pennsylvania Article 5
Committee wrote a report thereon dated March 12, 1998. That bill was not enacted during the 1999-2000
session, but the present Act incorporates Revised Article 5 substantially as set forth in that bill. The
present Committee, in consultation with the Pennsylvania Article 5 Committee, therefore deemed it appropriate to produce a single report covering the Act.

Accordingly, Annex II to this report sets forth the report of the Pennsylvania Article 5 Committee, updated by the present Committee to bring it current and to reflect the combination of Revised Article 5 with Revised Article 9. The Pennsylvania Comments to Revised Article 5 prepared by the Pennsylvania Article 5 Committee as part of their report have been incorporated into Annex I of this report. This report therefore supercedes the report of the Pennsylvania Article 5 Committee on the Act as initially introduced.

It is necessary to enact the two revision packages together in Pennsylvania. That is because the Official Text of Revised Article 9 assumes that the enacting state has previously enacted Revised Article 5. Revised Article 9 was carefully crafted to mesh with Revised Article 5 in respect of security interests in a letter of credit, and Revised Article 9 contains no alternative provisions for use by a state that has not upgraded its version of Article 5.

Quite aside from the necessity of enacting Revised Article 5 as a predicate to Revised Article 9, enactment of Revised Article 5 is important in its own right. Letters of credit are vital tools in international trade. As of April 2001, 46 states and the District of Columbia have enacted Revised Article 5. In order to preserve the advantages of uniformity, and to maintain Pennsylvania as a viable state for issuance of letters of credit, it is important that Pennsylvania follow suit promptly. Appendices C and D to this report reproduce two publications by NCCUSL that respectively summarize the principal reasons for states to enact Revised Article 5 and the principal substantive changes it makes to the pre-1995 text of Article 5 (referred to in this report as “Existing Article 5”).

E. Official Comments. As has always been the case with the UCC, the Official Text of Revised Article 9 and Revised Article 5 are accompanied by detailed section-by-section Official Comments (which term, as used in this report, includes the official Prefatory Note to Revised Article 5). Those Official Comments, which are incorporated by reference into this report, will be generally instructive in the application of Revised Article 9 and Revised Article 5.

F. Absence of Consumer Issues in Pennsylvania. The most contentious issues which arose in the drafting of Revised Article 9 at the national level related to the extent to which special rules should apply to consumer transactions. Those issues were extensively debated during the drafting process by representatives of consumer interests and secured creditors. Those issues were resolved by a compromise, implemented by Revised Article 9, which with minor exceptions generally continues the status quo on consumer issues. As part of that compromise, creditor representatives participating in the national drafting process agreed to provide active support for Revised Article 9 before state legislatures, and consumer representatives agreed not to oppose it and to encourage others not to oppose it.

The Act makes no substantive changes to the consumer-related provisions agreed to at the national level. No material opposition to acceptance of the “consumer compromise” reached at the national level was raised by or before the Committee.

As part of the national “consumer compromise,” certain rules included in Revised Article 9 to clarify perceived ambiguities in Existing Article 9 are limited to transactions other than consumer transactions. Hence Revised Article 9 leaves to the courts resolution of these arguable ambiguities in consumer transactions, just as under Existing Article 9. These rules are in the Official Text of the following sections:
The Act enacts these sections without substantive change. Courts applying Pennsylvania law on these matters in consumer transactions after enactment of Revised Article 9 presumably will resolve these arguable ambiguities in the same way as Pennsylvania courts have done under Existing Article 9. The Committee therefore researched the current Pennsylvania case law on these matters, and the results of that research are set forth in the section-by-section discussion in part VI of this report. However, it should be kept in mind that Revised Article 9 does not by its terms freeze existing case law on these matters in consumer transactions.

II. DRAFTING OF THE ACT

A. The Pennsylvania Committee. The Act was prepared by the Article 9 Task Force of the Business Law Section (formerly named the Section on Corporation, Banking and Business Law) of the Pennsylvania Bar Association, with the assistance of the Pennsylvania Legislative Reference Bureau. The Article 9 Task Force, which has issued this report, is for brevity referred to herein as the “Committee.” The Committee is geographically diverse and its members include private practitioners, in-house counsel, and members of the academic community. Some members of the Committee participated as observers in the national drafting effort. Members of the Committee received input from many other persons and groups, including members of the national drafting committee, persons involved in the drafting of legislation to enact Revised Article 9 in other states, members of the staff of NCCUSL, committees of the Pennsylvania Bar Association responsible for various substantive areas of the law affected by Revised Article 9, various county UCC filing offices, and the Pennsylvania Department of State. With respect to the amendments to the Pennsylvania laws pertaining to security interests in personal property covered by a certificate of title (motor vehicles, mobile homes, boats and all-terrain vehicles) the Committee consulted with the staffs of the agencies of the Commonwealth that administer these laws (the Department of Transportation, the Fish and Boat Commission and the Department of Conservation and Natural Resources) and members of affected trade groups, including the Pennsylvania Bankers Association and the Pennsylvania Automotive Association.

In preparing the Act, the Committee was informed by the Revised UCC Article 9 Enactment Guide (“Enactment Guide”) prepared by the Joint Task Force on Revised Article 9 Enactment Process. The Joint Task Force, which is sponsored by the Commercial Financial Services Committee and the Uniform Commercial Code Committee of the American Bar Association's Business Law Section and by the American College of Commercial Finance Lawyers, is comprised mainly of members of the national drafting committee which wrote Revised Article 9 and active observers of that drafting process. The Enactment Guide contains suggestions and guidance for the persons who are preparing Revised Article 9 for enactment in each state.8

8 The Enactment Guide is available at www.abanet.org/buslaw/cfs-ucc/ucc/article9/home.html, and has been made available through NCCUSL to the Commissioners of each state. The Enactment Guide referred to in this report is

Continued on following page
No substantial objections to Revised Article 9 were raised in Pennsylvania within or before the Committee.

B. Pennsylvania Comments. The Committee prepared Pennsylvania Comments, supplemental to the Official Comments, to certain sections of Revised Article 9 and other provisions added by the Act. The Pennsylvania Comments are set forth in Annex I to this report. As noted above, Annex I also includes Pennsylvania Comments to certain sections of Revised Article 5, prepared by the Pennsylvania Article 5 Committee. The Committee believes the Pennsylvania Comments in Annex I may be of lasting value in interpreting the Pennsylvania enactment of Revised Articles 5 and 9, and accordingly recommends that the Pennsylvania Comments be reprinted following the respective Official Comments in compilations of Pennsylvania laws that include the Official Comments, such as the widely-used compilation of Pennsylvania laws published by West Publishing Company.

C. Status of Report. This report, including the Pennsylvania Comments in Annex I hereto, the report on the Pennsylvania enactment of Revised Article 5 in Annex II hereto, and the Official Comments to Revised Articles 5 and 9 incorporated by reference herein, will become part of the legislative history of the Act under 1 Pa.C.S. § 1939 (relating to use of comments and reports).

III. ABOLITION OF THE DUAL FILING SYSTEM, FILING FEES AND RELATED MATTERS

Revised Article 9 abolishes the so-called “dual filing system” imposed by the current Pennsylvania enactment of Existing Article 9. Under the revision it will be unnecessary to file financing statements with county prothonotaries. As a result, Revised Article 9 will sharply decrease the number of financing statements filed each year in Pennsylvania. This change is of fiscal significance to the Commonwealth and to its counties. That is because Pennsylvania currently charges uniquely high fees for UCC filings with county filing offices. Pennsylvania’s county filing fees are more than twice those charged in any other state, and are many times larger than the national average. The Commonwealth’s fiscal interest derives from the fact that each county must remit to the Commonwealth General Fund 75% of the revenue the county garners from UCC filing fees; the county retains only the remaining 25%.

Accordingly, as well as abolishing the dual filing system, the Act comprehensively adjusts UCC filing fees in Pennsylvania. In general, the Act:

• Eliminates the requirement under existing law that counties remit to the Commonwealth a portion of the UCC filing fees they receive,

• Initially fixes UCC filing fees, as of the effective date of Revised Article 9, at $12 for filings with the Department of State and at $48 for filings with a county recorder of deeds, and

• Requires the Department of State, within 90 days after the enactment of the Act, to adjust these UCC filing fees by regulation, and directs the Department of State to adjust those fees (I) for

Continued from previous page
the second edition, dated February 28, 2000. E. Carolan Berkley and Kenneth C. Kettering, respectively Chair and Reporter for the Pennsylvania Committee, are Co-Chair and member of the Joint Task Force.
filings with the Department of State so as to achieve revenue-neutrality as compared with (in effect) the UCC filing fee revenue collected by the Commonwealth during fiscal year 1999-2000, and (II) for filings with county recorders of deeds so as to achieve revenue-neutrality for the counties collectively as compared with the UCC filing fees collected by the counties collectively during calendar year 2000.

The Act achieves these results through a nonuniform provision on filing fees, Revised 9525, together with conforming changes to other provisions of law.

This part III analyzes the dual filing system presently in force in Pennsylvania under Existing Article 9 and the consequences of its abolition by Revised Article 9.

A. The Dual Filing System and its Abolition by Revised Article 9.9 It is a fundamental principle of both Existing and Revised Article 9 that a secured party who wishes to perfect its security interest (that is, to make the security interest effective against third parties) commonly must file, in a public filing office identified in Article 9, a public notice of its security interest. That public notice is called a “financing statement.” Revised Article 9 changes the proper offices for filing financing statements in Pennsylvania.

Revised Article 9 contemplates that each state will have the same scheme of filing offices. That scheme, set forth in Revised 9501, is a simple and efficient one. The general rule is that all financing statements are filed with the state’s central filing office (in Pennsylvania, the Department of State). The only exception to this general rule is that a filing must be made with the county recorder of deeds (or the equivalent real estate recording office in other states) for so-called “real-estate-related filings” -- that is, financing statements in which the collateral is closely linked to particular real property. Examples include fixtures, timber to be cut, and minerals.10 Thus, under Revised Article 9, Pennsylvania will have two kinds of UCC filing offices: the Department of State to handle the vast bulk of filings, and the county recorders of deeds to handle real-estate-related filings.

By contrast, Pennsylvania has three kinds of UCC filing offices under current law: the Department of State, the county recorders of deeds, and also the county prothonotaries. The 1995 Official Text of Existing 9-401(1) provides three alternative schemes among which enacting states may choose in order to designate the proper filing offices in that state. Pennsylvania is one of the few states that chose the most elaborate of the three schemes, the “Third Alternative” set forth in Existing 9-401(1), codified in Pennsylvania in Existing 9401(a). Under this current law, the rules which designate the appropriate filing offices in Pennsylvania may be summarized as follows:

(a) The general rule, applicable unless paragraph (b) or (c) applies, requires a financing statement to be filed with the Department of State. In addition: (x) if the debtor has a place of business in only one county of Pennsylvania, a duplicative filing must also be made with prothonotary of that county, and (y) if the debtor has no place of business in Pennsylvania but

9 This part III.A is intended to explain the reasons for and effect of the abolition of the dual filing system. This discussion thus does not purport to be a complete analysis of the filing system under Existing or Revised Article 9.

10 Strictly speaking, a security interest in fixtures may be perfected by filing with the Department of State instead of the appropriate county recorder of deeds, but if the filing is made with the recorder of deeds (a so-called “fixture filing”) the secured party obtains the benefit of priority against certain competing claimants.
resides in Pennsylvania, a duplicative filing must also be made with the prothonotary of the county in which the debtor resides.

(b) For a few limited types of collateral, a filing is required to be made only with the prothonotary of a particular county and no duplicative filing is required to be made with the Department of State. This rule applies to certain farm-related collateral (such as equipment used in farming operations, farm products, receivables arising from sale of farm products by a farmer, and crops growing or to be grown). This rule also applies if the collateral is consumer goods. (Security interests in consumer goods are typically purchase-money security interests, however, and it is not necessary to file a financing statement at all in order to perfect a purchase money security interest in consumer goods. Hence filings against consumer goods pursuant to this rule should be rare.)

(c) Real-estate related filings are made with the appropriate county recorder of deeds, as under Revised Article 9.

Most filings under current law are governed by the general rule stated in paragraph (a), and hence require a filing with the Department of State. Under that rule, it is typically the case that for each such filing made with the Department of State a duplicative filing is made with at least one county prothonotary. According to the letter of the rule, no such duplicative filing is required if the debtor is a business enterprise having places of business in more than one county in Pennsylvania, and it is never necessary to make duplicative filings with more than one prothonotary. However, if the debtor has places of business in more than one county the secured party often will, as a precaution, make duplicative filings with the prothonotary of each of those counties. The reason can be seen from the following example:

Example: In year 1, Debtor borrows on a secured basis from Secured Party. At that time, Debtor has two places of business, one in Allegheny County and one in Erie County. Under the rule in paragraph (a), Secured Party will be perfected if it files a financing statement only with the Department of State. In year 2, however, after the loan is made and Secured Party has filed its financing statements against Debtor, Debtor sells or shuts down its place of business in Allegheny County. At that point Debtor has a place of business only in one county, and so under the rule of paragraph (a) it will be necessary for Secured Party to make a duplicative filing with the Erie County prothonotary in order to remain perfected. If Secured Party does not promptly learn of the sale or shutdown, appreciate its significance, and file a financing statement with the Erie County prothonotary, Secured Party will become unperfected.

Hence a secured loan to a debtor having operations in more than one county often results in multiple duplicative filings with different prothonotaries, in addition to the filing with the Department of State.

According to the Department of State, the number of UCC filings in the UCC filing offices in Pennsylvania during the fiscal year 1998-99 (counting both UCC-1s filed as initial financing statements and UCC-3s filed to amend, assign or terminate an existing financing statement, in each case whether on a standard or nonstandard form) were as follows:

Table 1
UCC Filings in Pennsylvania, Fiscal Year 1998-99

<table>
<thead>
<tr>
<th></th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of State</td>
<td>132,058</td>
</tr>
<tr>
<td>Prothonotaries (all counties)</td>
<td>167,957</td>
</tr>
<tr>
<td>Recorders of Deeds (all counties)</td>
<td>31,998</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>332,013</strong></td>
</tr>
</tbody>
</table>
There are no statistics available as to how many of the 167,957 filings made with prothonotaries were made in transactions governed by the rule stated in paragraph (a) above, as opposed to paragraph (b). Based on the experience of its members, however, the Committee believes that the vast majority of the filings made with prothonotaries are made in transactions governed by the rule stated in paragraph (a), and hence duplicate filings made with the Department of State.

Pennsylvania’s dual filing system was defensible when adopted in the 1950s, but in today's world is archaic and wasteful. Given modern methods of communication, a single filing with the Department of State amply suffices to give notice to the world of a security interest. Duplicative filings with prothonotaries serve no purpose in today's world, and add greatly to the time and expense of making a filing and of conducting a comprehensive lien search. Most states never adopted, or have abandoned, the dual filing system.11 As noted above, Revised Article 9 eliminates it as an alternative available to enacting states.

B. Other Changes Affecting the Number of UCC Filings Made in Pennsylvania. By eliminating the dual filing system, Revised Article 9 will dramatically reduce the aggregate number of filings required to be made in Pennsylvania. The effect of this change is to (i) eliminate all future filings with county prothonotaries in transactions that under current law are governed by the rule stated in paragraph (a), and (ii) shift from county prothonotaries to the Department of State all future filings in transactions that under current law are governed by the rule stated in paragraph (b). Thus, considering only the effect of this change, the aggregate number of filings made in fiscal 1998-99 in all Pennsylvania filing offices, if Revised Article 9 had then been in force, would reduce from the actual figure of 332,013 to (132,058 + 31,998 + X), or 164,056 + X. Here, “X” stands for the portion of the 167,957 filings made with prothonotaries that were made in transactions governed by the rule in paragraph (b) under current law. As noted above, there are no statistics available as to the size of X, but the Committee believes it to be relatively small.

Many other changes made by Revised Article 9 will affect the number of filings made in Pennsylvania, although the consequences of the abolition of dual filing will dwarf the effects of these other changes. Among these other changes are the following:

(i) Probably the most significant change relates to the choice of law provisions that designate the appropriate state in which to file. Under Existing Article 9, the appropriate state in which to file depends on the nature of the collateral. These choice of law rules are lengthy and detailed, but broadly speaking they provide as follows: (x) for intangible collateral, such as accounts receivable, the filing must be made in the single state where the debtor is deemed to be “located,” as defined in Article 9, and (y) for tangible collateral such as ordinary goods, a filing must be made in the state where the goods are located. (Existing 9103). As a result, under Existing Article 9, if a debtor has operations in many states and grants a blanket lien (that is, a security interest in all of its property), it may be necessary for the secured creditor to file in each state in which the debtor has operations in order to perfect its security interest. By contrast, under Revised Article 9, with few exceptions, a filing need be made only in the single state where the debtor is “located.” (Revised 9301(1)). This “one-stop filing” will diminish the number of states in which filings are necessary with respect to a debtor having operations in more than one state, 11 Nine states are currently dual filing jurisdictions: Arkansas, Massachusetts, Mississippi, Missouri, New York, North Carolina, Ohio, Pennsylvania and Virginia. New Hampshire is a dual filing jurisdiction but is scheduled to become a central filing jurisdiction on July 1, 2001.
and hence will reduce the overall number of UCC filings required to be made nationwide, compared to Existing Article 9. Quantification of the effect of this change would be quite difficult, and to the knowledge of the Committee no quantitative study of the effect of this change has been made nationwide or in any jurisdiction.

(ii) Revised Article 9 also redefines where a debtor is deemed to be “located” for the purpose of these choice of law rules. Under current law, if a corporate debtor grants a security interest in intangible collateral such as accounts receivable, a financing statement must be filed in the state where the debtor is “located,” and a corporate debtor usually will be deemed to be “located” in the state in which its chief executive office is located. (Existing 9103). Under the revision, a financing statement must still be filed in the state where the debtor is “located,” but a corporate debtor usually will be deemed to be “located” in the state of its organization. (Revised 9307). This change will not affect the total number of filings made nationwide, but will cause some filings that would have been made in one state under Existing Article 9 to be made in a different state. The effect of this change has been quantified and shown to be small. See Lynn M. Lopucki, Why the Debtor’s State of Incorporation Should be the Proper Place for Article 9 Filing: A Systems Analysis, 79 MINN. L. REV. 577 (1995).

(iii) Revised Article 9’s transitional rules contemplate that if a secured party has a financing statement on file before the effective date of Revised Article 9 in a filing office that was proper under Existing Article 9, and desires to continue or amend that pre-effective-date filing, the secured party in some circumstances may have to file a new initial financing statement (which must cross-reference that pre-effective-date filing) with the filing office that is the proper place for filing under Revised Article 9. See Revised 9-705, 9-706, 9-707. The purpose of this new initial financing statement is to get a record of the old filing into the new filing system. Such new initial financing statements would not have to be filed if the revision were not enacted.

(iv) The broadening of the scope of Article 9 effected by the revision may also affect the number of filings made under the revision.

There is no easy way to quantify the effect of any of these changes, and to the knowledge of the Committee there has been no attempt to quantify the effect of any of these changes at the national level, with the exception of the single factor noted in point (ii) above. Any estimate of the effect of Revised Article 9 on the number of filings made in Pennsylvania thus can be only an informed guess. In any event, general economic conditions pertaining to the supply of and demand for secured credit will also have a major effect on the number of filings made in Pennsylvania from year to year, quite aside from the effect of any of these legal changes.

Notwithstanding these uncertainties, it is necessary to estimate the effect of Revised Article 9 on the rate of Pennsylvania filings in order to quantify the fiscal effect of enactment. While a range of estimates is defensible, the Committee believes it reasonable to suppose that the aggregate number of filings per annum in Pennsylvania under Revised Article 9 will be equal to the number of filings made under Existing Article 9 with the Department of State and county recorders of deeds. In short, the prothonotary filings simply disappear.

C. Filing Fees.

1. Current UCC Filing Fees in Pennsylvania. Current Pennsylvania law on fees collected by filing offices for services provided under Article 9 is not contained in Article 9 itself, but is scattered among numerous statutes outside of the UCC. The baseline provisions are in the Corporation
Bureau and UCC Fee Law, 15 Pa.C.S. §§ 151-155 (“CBUFL”). The CBUFL sets forth the fees charged by the Department of State for UCC filings and related services, such as searches. The CBUFL also sets forth the fees charged by county filing offices (that is, county prothonotaries and recorders of deeds) for UCC filings and services. However, as to county filing offices, the CBUFL states that the baseline fees set forth in that statute are subject to adjustment as provided by other laws. There are several such other laws applicable to different classes of prothonotaries and recorders of deeds.12

In summarizing Pennsylvania’s current fee structure we shall focus on filing fees, because revenues from searches are negligible.13 Under the baseline provisions set forth in the CBUFL, the Department of State charges $12 per debtor name for filing a standard form UCC-1 financing statement, and $12 for filing a standard form UCC-3 amendment (regardless of the number of debtors named). A county prothonotary or recorder of deeds in calendar year 1999 charged $56.50 per debtor name for filing a standard form UCC-1, and $56.50 for filing a standard form UCC-3 (again, regardless of the number of debtors named). These county filing fees (but not the state filing fee) are adjusted annually for inflation each January 1, though this annual adjustment is scheduled to cease on January 1, 2001.14 If the filing is made on a nonstandard form, the Department of State charges an additional $28, and the county filing offices in calendar year 1999 charged an additional $131 (this county charge also being subject to adjustment for inflation each January 1 through 2001).

As noted earlier, the counties are entitled to keep only 25% of the revenue they derive from UCC filing fees. The CBUFL states that 75% of the county UCC fees “shall be payable to the Commonwealth and shall be deposited in the General Fund.” See 15 Pa.C.S. §153(a)(8)(vii).

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12 These include the following statutory fee schedules, each of which is amended by the Act:
Act of April 20, 1949, P.L. 644, No. 143, as amended, 16 P.S. §7629 (recorders of deeds in first class counties);
Act of June 12, 1919, P.L. 476, No. 240, as amended, 16 P.S. §11411 (recorders of deeds in second class counties);
42 Pa.C.S. § 1725 (prothonotaries in first class counties);
Act of April 8, 1982, P.L. 303, No. 85, as amended, 42 P.S. § 21042 (prothonotaries in second class counties); and
Act of April 8, 1982, P.L. 310, No. 87, 42 P.S. § 21051 (recorders of deeds in counties of classes second A and third through eighth).
The fee schedules for prothonotaries of counties of classes second A and third through eighth are contained in 41 P.S. §§ 21071, 21161, but these fee schedules do not refer to UCC filing fees and hence require no amendment.

13 According to the Department of State the number of search requests responded to by Pennsylvania UCC filing offices and aggregate fees derived therefrom in fiscal 1998-99 were as follows:

<table>
<thead>
<tr>
<th>Filing Office</th>
<th>Number of Search Requests</th>
<th>Aggregate Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of State</td>
<td>5,427</td>
<td>$84,222</td>
</tr>
<tr>
<td>Prothonotaries (all counties)</td>
<td>1,295</td>
<td>$4,851</td>
</tr>
<tr>
<td>Recorders of Deeds (all counties)</td>
<td>21</td>
<td>$70</td>
</tr>
</tbody>
</table>

Many more UCC searches are performed than are shown in this table, but most are performed “over the counter” or through private search companies, rather than by requesting the filing office to make the search.

14 As a result of this adjustment for inflation, the county filing fee for the calendar year 2000 increased to $57.50. For simplicity and consistency this report generally refers to the county filing fees for the calendar year 1999.
The aggregate revenues from UCC-1 and UCC-3 filings in Pennsylvania for the 1998-99 fiscal year, and the division of those revenues between the Commonwealth and the counties, are as shown in the following table:

Table 2
Pennsylvania UCC Filing Fee Revenue FY 1998-99, and State/County Apportionment

<table>
<thead>
<tr>
<th>(a) Filing Office</th>
<th>(b) Aggregate filing fees for UCC-1s and -3s filed at this office</th>
<th>(c) Commonwealth's Share of col. (b) (for line 1, 100%; for lines 2 and 3, 75%)</th>
<th>(d) Counties' Share of col. (b) (for line 1, 0%; for lines 2 and 3, 25%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of State</td>
<td>$1,696,508</td>
<td>$1,696,508</td>
<td>0</td>
</tr>
<tr>
<td>Prothonotaries (all counties)</td>
<td>$9,607,994</td>
<td>$7,205,996</td>
<td>$2,401,998</td>
</tr>
<tr>
<td>Recorders of Deeds (all counties)</td>
<td>$1,837,919</td>
<td>$1,378,439</td>
<td>$459,479</td>
</tr>
<tr>
<td>Total</td>
<td>$13,142,241</td>
<td>$10,280,943</td>
<td>$2,861,478</td>
</tr>
</tbody>
</table>

2. Current UCC Filing Fees in Other States. Comparison of Pennsylvania’s UCC filing fees with those charged in other states is complicated by the fact that different states charge fees on different bases. Thus, some states charge extra fees for filings not made on a standard form; some charge a per-page fee (sometimes allowing a certain number of free pages); some charge extra fees if more than one debtor is named in the filing; some charge fees on a different basis for UCC-3s than for UCC-1s (or no fee at all for UCC-3s filed to terminate an existing UCC-1), etc. Moreover, different filing offices in a single state may charge fees on different bases. Standardizing the basis on which fees are assessed is indeed one of the goals of Revised Article 9, because the most common reason why filings are rejected is tender of the wrong fee.

For purposes of comparison, it is useful to focus on the filing fee for a “plain vanilla” UCC-1: that is, a filing on the national standard form, listing one debtor, with no attachments.

Current Central Filing Fees Nationwide. Based on a survey dated September 15, 1999 prepared by Lexis Document Services, Inc., the highest fee charged by any state central filing office for a plain vanilla UCC-1 is $35 (charged by one state, New Jersey). The lowest fee is $3 (charged by two states, Michigan and Mississippi). Pennsylvania’s central filing fee is, as noted above, $12. The range is as follows:

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15 The presentation in Table 2, based on information provided by the Department of State, is slightly simplified, and the Committee has prepared a more detailed analysis. In addition, note that the table relates only to UCC filing fees, and hence does not include search fees, nor does it include certain minor optional fees (such as fees collected by recorders of deeds from filers who desire their filings to be indexed in the real estate index). Fees from these other sources are minor compared to filing fees.
Table 3
UCC Filing Fees, by State, for Filings with the State’s Central Filing Office
(as of September 15, 1999)\textsuperscript{16}

<table>
<thead>
<tr>
<th>Greater than</th>
<th>Less than or equal to</th>
<th>Number of States</th>
<th>States</th>
</tr>
</thead>
<tbody>
<tr>
<td>$35</td>
<td>Any</td>
<td>0</td>
<td>--</td>
</tr>
<tr>
<td>$30</td>
<td>$35</td>
<td>1</td>
<td>New Jersey ($35)</td>
</tr>
<tr>
<td>$25</td>
<td>$30</td>
<td>1</td>
<td>California ($26)</td>
</tr>
<tr>
<td>$20</td>
<td>$25</td>
<td>5</td>
<td>CN, DE, FL, HA, ME ($25)</td>
</tr>
<tr>
<td>$15</td>
<td>$20</td>
<td>6</td>
<td>CO ($16), DC, IL, LA, MD, RI ($20)</td>
</tr>
<tr>
<td>$10</td>
<td>$15</td>
<td>13</td>
<td>Pennsylvania and others</td>
</tr>
<tr>
<td>$5</td>
<td>$10</td>
<td>20</td>
<td>Many</td>
</tr>
<tr>
<td>$0</td>
<td>$5</td>
<td>5</td>
<td>MI, MS ($3), IN ($4), AZ, UT ($5)</td>
</tr>
</tbody>
</table>

Current County Filing Fees Nationwide. The survey referred to above also shows that no other state has county filing fees anywhere close to Pennsylvania’s 1999 basic fee of $56.50. After Pennsylvania, the next highest county filing fee charged for a plain vanilla UCC-1 is $27, charged by certain counties in Delaware. New Jersey counties and one county in Georgia charge $25. For all other county filing offices in the country the filing fee is less than $25. With few exceptions, other states’ county filing fees are the same as or within $5 of the central filing fee for the state.

3. UCC Filing Fees in Pennsylvania under Revised Article 9. Because Revised Article 9 will greatly reduce the number of UCC filings made in Pennsylvania, the aggregate fee revenue collected by the various Pennsylvania filing offices will necessarily be reduced as well, unless the filing fees are increased to compensate.

For the introduction of Revised Article 9 to be revenue-neutral, a substantial increase in the filing fees would be necessary as compared to the fees charged under Existing Article 9. Determination of a revenue-neutral fee structure requires prediction of how Revised Article 9 will affect the total number of filings at each Pennsylvania filing office. For reasons described in part III.B above, any such prediction must be based in large part upon guesswork. Moreover, any prediction based on purely legal criteria is apt to be swamped by fluctuations in the economy affecting the number of secured borrowings from year to year. As noted earlier, based on the information available to the Committee, the Committee believes that a reasonable estimate of the effect of Revised Article 9 immediately following its effective date will be to leave the rate of filings with the Department of State and the county recorders of deeds unchanged, while wiping out all further filings with the county prothonotaries. On that assumption, based on the number of filings made in Pennsylvania and the filing fees collected from such filings in the 1998-99 fiscal year, and with no sharing of fee revenue by counties with the Commonwealth or vice versa, the revenue-neutral filing fee at the Department of State would be approximately $78 and the revenue-neutral filing fee at the county recorders of deeds would be approximately $90.\textsuperscript{17}

\textsuperscript{16} This table includes the District of Columbia. Two states, Louisiana and Georgia, have eccentric nonuniform filing systems which include no central filing office at all; all filings in those states are made at the parish/county level. Louisiana is counted in the above table at $20, the uniform filing fee for each parish; Georgia is counted at $10, the filing fee for each county except one (which charges $25). At least three states (Florida, Maryland and Tennessee) charge in addition to a filing fee a tax on the debt or debt instrument associated with UCC filings.

\textsuperscript{17} The calculation is as follows: As shown in Table 2, revenue to the Commonwealth from UCC-1 and UCC-3s filed in the Commonwealth during fiscal 1998-99 (including the Commonwealth’s share of county filing fees and all
Such filing fees would be the highest in the country. But the Committee believes that such filing fees can be borne. The additional cost to users of the revised fee structure, as compared with current law, would be relatively small even in obvious dollar terms, and the Committee believes that users of the system would be decidedly better off when less obvious costs are taken into account. Thus, a typical filing with the Department of State today must be mirrored with a duplicative filing with at least one prothonotary, resulting in an aggregate filing fee (at 1999 levels) of $12 plus $56.50, or $68.50. That is not radically lower than the $78 that would be required for the single filing with the Department of State under Revised Article 9 with a revenue-neutral fee structure. The benefit to the secured party of not having to prepare the duplicative filing and deal with two different filing offices should more than amply compensate for the additional $9.50. Dual filing also doubles (at least) the time and expense of doing comprehensive lien searches. Finally, the dual filing requirement multiplies the chance of an error in filing that may have the effect of depriving the secured party of its perfection when it most needs it.

As noted earlier, the Act contemplates that the introduction of Revised Article 9 will be revenue-neutral both to the Commonwealth and to the counties collectively. The Act does so by giving the Department of State power to vary by regulation the filing fees collected both by the Department of State and by county recorders of deeds, and by directing the Department of State to adjust those fees (I) for filings with the Department of State so as to achieve revenue-neutrality as compared with the UCC filing fees collected during fiscal year 1999-2000, and (II) for filings with county recorders of deeds so as to achieve revenue-neutrality for the counties collectively as compared with the UCC filing fees collected by the counties collectively during calendar year 2000. See Revised 9525.

As a result of the abolition of the dual filing system, after the effective date of Revised Article 9 UCC filing fees will be collected at the county level only by county recorders of deeds, and will no longer be collected by county prothonotaries. If nothing further were done, therefore, Revised Article 9 would change the allocation of revenue at the county level as between the office of the prothonotary and the office of the recorder of deeds. The Act addresses that subject by amendments to the CBUFL, specifically 15 Pa.C.S. § 153(d). Generally speaking, that provision states that UCC filing fees received by a county recorder of deeds after the effective date of Revised Article 9 will be credited to the county recorder of deeds and the county prothonotary on the basis of the amount collected in each office in calendar year 2000, excluding any amounts paid to the Commonwealth. Revenue received in excess of the total amount received by each office during the year 2000, excluding amounts paid to the Commonwealth, will be distributed pro rata to the county recorder of deeds and the county prothonotary.

Continued from previous page

of the fees collected by the Department of State) was $10,280,943. That revenue must be raised from an assumed annual 132,058 filings with the Department of State under Revised Article 9 (that being the actual number of filings with the Department under Existing Article 9 in that fiscal year). The result of dividing $10,280,943 by 132,058 is $77.85, which is rounded to $78. Per the same table, revenue to the counties from UCC-1 and UCC-3s filed during fiscal 1998-99 (after deducting the Commonwealth’s share) was $2,861,478. That revenue must be raised from an assumed annual 31,998 filings with the county recorders of deeds under Revised Article 9 (that being the actual number of such filings with recorders of deeds under Existing Article 9 in that fiscal year). The result of dividing $2,861,478 by 31,998 is $89.42, which is rounded to $90. Note that the foregoing calculations are based on data for fiscal 1998-99, which is the latest information available to the Committee. The Act contemplates revenue neutrality based on fees for fiscal 1999-2000 (in the case of the Department of State) and calendar 2000 (in the case of county filing offices). Accordingly, the foregoing calculation of revenue-neutral fee levels are approximations.
D. Transition Rules for Prothonotaries' Offices. Under the Act, from and after the effective date of Revised Article 9 (that is, July 1, 2001), prothonotaries' offices in Pennsylvania may not accept further filings under the UCC: they will no longer serve as filing offices for new financing statements, and they may not accept any further filings (such as amendments and termination statements) with respect to pre-effective date filings. However, under the transition rule set forth in Revised 9705, financing statement filings made in prothonotaries' offices before the effective date may still remain effective for a five-year transition period, ending on June 30, 2006. Hence, although prothonotaries' offices will no longer accept any further filings on or after July 1, 2001, during the transition period it will be necessary for them to continue to maintain their records and respond to search requests.

Because of the relatively small number of jurisdictions that have dual filing, the Official Text of Revised Article 9 does not contain a transition rule providing for the continued limited operation of prothonotaries' offices (and their equivalents in other dual filing states) during this five-year transition period. To supply this gap in the Official Text, the Enactment Guide contains a model provision on this point. However, that provision is drafted in a complex and abstract manner in order to accommodate variations in states’ local filing schemes. The Act enacts a nonuniform Section 9710 that is patterned on that model provision. However, Pennsylvania’s particular local filing scheme permitted that provision to be adopted in a much simplified form. Revised 9710 requires prothonotaries during the transition period to continue to maintain their existing UCC files and indices as of the effective date, and to respond to search requests, but not accept any further filings.

Revised 9710 further provides that prothonotaries may charge fees for responding to search requests as permitted by law immediately before the effective date, subject to the Department of State’s power to issue regulations varying those fees.

For further discussion of the transition rules applicable to prothonotaries' offices, see the Pennsylvania comments to Revised 9707 and 9710 in Annex I to this report.

IV. NONUNIFORM PROVISIONS OF PENNSYLVANIA'S ENACTMENT OF EXISTING ARTICLE 9 AND THEIR DISPOSITION UNDER REVISED ARTICLE 9

With few exceptions, the Pennsylvania enactment of Existing Article 9 is substantively identical to the 1995 Official Text of Existing Article 9. This part IV identifies those few substantive differences and notes their disposition in the enactment of Revised Article 9 pursuant to the Act.

Certain provisions of the 1995 Official Text of Existing Article 9 leave a blank for enacting states to complete or provide alternative language for enacting states to choose from. The corresponding provisions of the Pennsylvania enactment of Existing Article 9 that merely fill in the blank or choose one of the suggested alternatives are not considered nonuniform features of Pennsylvania's enactment and hence are not discussed in this part IV.

Pennsylvania’s enactment of Existing Article 9 makes many changes in the 1995 Official Text to conform to Pennsylvania legislative drafting style. Such stylistic changes have no substantive effect and are not generally discussed in this report. However, one such stylistic change merits comment. Historically, the Official Text of the UCC included only section captions, which the Official Text states are part of the law. See Existing 1-109 (1995 Official Text). By contrast, following longstanding Pennsylvania drafting style, Pennsylvania’s enactment of Existing Article 9 includes subsection captions as well as section captions. Pennsylvania’s subsection captions, however, have no legal effect. Pennsylvania’s enactment of Existing 1109 states, per the Official Text, that section captions are to be
considered part of the law, but also goes on to state, nonuniformly, that subsection captions are not to be
considered part of the law. The Official Text of Revised Article 9 includes official subsection captions as
an option for enacting states, an innovation in UCC drafting style introduced by Revised Article 9. The
Official Text contemplates that subsection captions, if used by an enacting state, will not be part of the
law. See Revised 9-101, Comment 3. This is consistent with Pennsylvania’s nonuniform enactment of
Existing 1109. Hence no change in Pennsylvania law is necessary in order to accommodate the
introduction of subsection captions in the Official Text.

**Existing 9103, 9104, 9105, 9106, 9304 and 9305.** As discussed in part III.D of this
report, Pennsylvania has not yet enacted Revised Article 5, relating to letters of credit, which was
promulgated in 1995. Revised Article 5 made conforming changes to the Official Text of Existing 9-103,
9-104, 9-105, 9-106, 9-304 and 9-305. Pennsylvania’s current enactment of those sections naturally does
not include those changes. The Act enacts Revised Article 5, as well as Revised Article 9. The Revised
Article 9 revision package supercedes the conforming changes to Existing Article 9 that were part of the
Revised Article 5 package, and the Act does not enact those superceded conforming changes.

**Existing 9104(5).** Existing 9-104(e) of the 1995 Official Text excludes from the scope of
Article 9 any “transfer by a government or governmental subdivision or agency”. This effectively
excludes from the scope of Article 9 any liens granted by a governmental unit. This exclusion was added
to the Official Text of Article 9 in the 1972 revisions. When Pennsylvania adopted the 1972 revisions in
1982, Pennsylvania adopted that governmental exclusion. That exclusion created a void in the general
Pennsylvania law applicable to liens granted by governmental units. A year later, in 1983, Pennsylvania
repealed this exclusion, thus making Article 9 generally applicable to liens granted by governmental
units. See Act of July 1, 1983, P.L. 29, No. 17, § 1. However, several Pennsylvania statutes govern
the validity and perfection of liens granted by particular governmental units. See, e.g., 24 P.S. § 5505; 73
P.S. § 376.3. These statutes thus overlap the Pennsylvania enactment of Existing Article 9.

Revised Article 9 takes a more nuanced approach to this scope issue than does Existing
Article 9. The Official Text of Revised 9-109(c)(2), which the Act enacts in uniform form, provides, in
effect, that Revised Article 9 does not apply to a security interest granted by a governmental unit of the
Commonwealth to the extent that another statute of the Commonwealth expressly governs the creation,
perfection, priority or enforcement of a security interest created by the Commonwealth or a governmental
unit of the Commonwealth. The Committee believes that Revised 9109(c)(2) is an appropriate response
to the overlap between Article 9 and the other Pennsylvania statutes that apply to governmental liens.

**Existing 9105(a), 9106, 9115.** Each of these provisions sets forth one or more defined
terms. In accordance with customary Pennsylvania drafting style, the Pennsylvania enactment adds the
phrase “except where the context otherwise requires” to the preamble of each of these provisions. That
phrase is not used in the definitional provisions of the 1995 or 1999 Official Text. The Act follows the
Official Text of Revised Article 9 and does not use that phrase.

**Existing 9203(a).** In the 1995 Official Text of Existing 9-203(1), the preamble states that
the general rules on attachment and enforceability of security interests set forth in that section are subject
to the provisions of various other sections, including “Section 9-113 on a security interest arising under
the Articles on Sales and Leases”. The Pennsylvania enactment of this language, Existing 9-203(a), refers
to “section 9113 on a security interest arising under the division on sales”, thus omitting the reference to
the division on leases. Sales and leases are dealt with in Articles 2 and 2A of the Official Text of the
UCC, which are Division 2 and 2A of the Pennsylvania enactment. This omission of the reference to
leases was plainly an error in the Pennsylvania enactment of Existing 9203(a), as the Pennsylvania
version of Existing 9113 adheres to the Official Text and does refer to the division on leases as well as the
division on sales. The Act corrects that error. The successor to Existing 9203(a) is Revised 9203(c), which the Act enacts in uniform form.

**Existing 9301(b).** The Pennsylvania enactment of this provision states that if the secured party files a financing statement with respect to a purchase money security interest before or within 20 days after the debtor receives possession of the collateral, the secured party takes priority over the rights of a transferee in bulk or a lien creditor which arise between the time the security interest attaches and the time of filing. The corresponding provision of the 1995 Official Text, Existing 9-301(b), provides for a 10 day period rather than a 20 day period. The successor rule in both the Official Text and Pennsylvania enactment of Revised Article 9, Revised 9-317(e), adopts a 20 day period.

**Existing 9312(d).** The Pennsylvania enactment of this provision states that a purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter. The corresponding provision of the 1995 Official Text, Existing 9-312(4), provides for a 10 day period rather than a 20 day period. The successor rule in both the Official Text and Pennsylvania enactment of Revised Article 9, Revised 9-324(e), adopts a 20 day period.

**Existing 9313(d)(3).** The Pennsylvania enactment of this provision states in effect that a perfected purchase money security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate in the event that “the fixtures are readily removable office machines or readily removable replacements of domestic appliances which are consumer goods, and before the goods become fixtures the security interest is perfected by any method permitted by this division”. The corresponding provision of the 1995 Official Text, Existing 9-313(4)(c), uses the phrase “readily removable factory or office machines” in lieu of “readily removable office machines” (emphasis added). This nonuniformity was introduced into Pennsylvania law in 1982, when Pennsylvania adopted the 1972 revisions to the Official Text of Article 9, which rewrote the Official Text of Existing 9-313 in its entirety. The result of the nonuniformity is that in a priority battle between an equipment financier and a real estate financier, the current Pennsylvania enactment is less favorable to the equipment financier than is the 1995 Official Text. Under the 1995 Official Text of this provision a purchase-money equipment financier can prevail over a real estate financier in “readily removable factory or office machines” whereas under the current Pennsylvania enactment of this provision a purchase-money equipment financier can prevail over a real estate financier only as to “readily removable office machines”.

The Committee is not aware of any contemporaneous explanation of the purpose of this nonuniformity. Assuming that this nonuniformity was intentional, it seems probable that the reason for affording this benefit to real estate lenders derives from Pennsylvania’s archaic and all-but-unique “assembled industrial plant doctrine.” As discussed later in this report, that doctrine may cause industrial equipment to be deemed a fixture, and hence subject to a real estate lien, even if the equipment is not physically affixed to the real estate. Putting to one side the question whether this nonuniformity is wise even given the assembled industrial plant doctrine, the Act repeals that doctrine, and so removes any justification for this nonuniformity. The successor provision to Existing 9-313(4)(c) in the Official Text of Revised Article 9, Revised 9-334(c)(2)(A), refers to readily removable “factory or office machines,” and the Act adheres to the Official Text.

**Existing 9403, 9404, 9405, 9406, 9407.** In the 1995 Official Text, Existing 9-403(5), 9-404(1), 9-404(3), 9-405(1), 9-405(2), 9-406 and 9-407(2) each set forth the fee which the filing office may charge for performing various services, such as filing and indexing a financing statement or an
amendment thereto, or complying with a search request. The current Pennsylvania enactment of these provisions deletes these language pertaining to fees and makes conforming editorial changes. As described in part III.C.1 of this report, under current Pennsylvania law, UCC filing and search fees are dealt with outside the UCC by various statutes applicable to different types of filing offices. For a discussion of UCC fees as revised by Act, see part III.C.3 of this report.

**Existing 9407(b).** The Pennsylvania enactment of this provision states in effect that upon request of any person, a filing office shall issue a certificate showing whether there is on file an effective financing statement naming a particular debtor and, if there is, giving the date and hour of filing of each such financing statement, the file number thereof and the names and addresses of each secured party therein. The corresponding provision of the 1995 Official Text, Existing 9-407(2), does not require the certificate to list the file number of each financing statement. The Committee is not aware of any contemporaneous explanation of the motivation for this nonuniformity.

The successor provision in Revised Article 9, Revised 9-523, does not require that a filing office responding to a search request give the file number of each financing statement found. The Committee does not believe it necessary to add a nonuniform provision requiring filing offices to do so.

**Existing 9409.** This is a nonuniform Pennsylvania provision having no close analogue in the 1995 Official Text. In effect it permits filing offices to dispose of original filings if the filing office has made a microfilm or other accurate reproduction of them. Revised Article 9 contains a uniform provision to similar effect, Revised 9522(b).

**Existing 9410.** This is a nonuniform Pennsylvania provision having no close analogue in the 1995 Official Text. In effect it provides that a filing office has no duty with respect to papers filed or submitted for filing if not clearly legible. Revised Article 9 contains a uniform provision to similar effect, Revised 9516(c)(1).

**Existing 9503.** This section deals with the secured party’s right to take possession on default. The Official Text of Existing 9-503 states, among other things, that “[u]nless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party can proceed without judicial process if this can be done without breach of the peace or may proceed by action.” The section also deals with the debtor’s duty to assemble the collateral, the secured party’s right to render equipment unusable without removal and the secured party’s right to dispose of collateral on the debtor’s premises. The current Pennsylvania enactment of this section retains the Official Text without substantive change as Existing 9503(a). It adds a nonuniform subsection (b), which states: “If a secured party elects to proceed by process of law he may proceed by writ of replevin or otherwise.” This nonuniform language was added to the Pennsylvania UCC by the 1959 reenactment, the Act of October 2, 1959, P.L. 1023, § 9.

In the Committee’s view this nonuniform language is surplusage. The Official Text expressly allows the secured party to “proceed by action” and leaves the appropriate procedure to applicable state procedural law. To say that the secured party “may proceed by writ of replevin or otherwise” adds nothing. This language was added relatively early in the enactment history of the UCC, when the UCC and its most revolutionary segment, Article 9, were both relatively unfamiliar, and the Committee believes that the addition of this language likely was due to abundance of caution.18 The

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18 See Schnader, supra note 3, at 275 n.34 (this additional Pennsylvania language “does not affect uniformity. It is merely a variation deemed necessary to conform with the Pennsylvania procedure on replevin.”)
Committee believes it unnecessary to add similar nonuniform language to the Pennsylvania enactment of Revised 9-609, the successor to Existing 9-503.

V. AMENDMENTS TO PENNSYLVANIA’S CERTIFICATE OF TITLE STATUTES

Revised 9311, like its predecessor in existing law, Existing 9302, provides in effect that compliance with a certificate of title statute for titled goods is equivalent to the filing of a financing statement if notation of the secured party's security interest on the certificate of title is a condition to or result of perfection of the secured party's security interest. At present the following four Pennsylvania statutes contemplate issuance of a document referred to by the statute as a “certificate of title”:

- Vehicle Code, 75 Pa.C.S., chapter 11 (applicable to vehicles; administered by the Department of Transportation);
- Mobile Home Titling Act, Act of July 25, 1977, P.L. 95, No. 35, 68 P.S., chapter 22 (applicable to mobile homes; administered by the Department of Transportation);
- Fish and Boat Code, 30 Pa.C.S., chapter 53, and regulations at 58 Pa. Code § 98.101 et seq. (applicable to boats; administered by the Fish and Boat Commission); and
- Snowmobile and All-Terrain Vehicle Law, 75 Pa.C.S., chapter 77 (“SATVL”) (applicable to all-terrain vehicles (“ATVs”); administered by the Department of Conservation and Natural Resources).

It is not entirely clear whether SATVL as presently constituted is a “certificate of title” statute for purposes of Article 9: while SATVL contemplates issuance of a document referred to as a “certificate of title” with respect to ATVs, SATVL does not clearly provide for a security interest to be indicated on that document as a condition to or result of perfection, which is necessary in order for the document to qualify as a “certificate of title” as defined in Article 9. See Revised 9102(a).

The Act makes changes to all four of these Pennsylvania certificate of title statutes, in order to conform them to Revised Article 9 and to modernize and clarify their operation as they relate to secured transactions.19 The Committee consulted with the legal staffs of the Department of Transportation, the Fish and Boat Commission and the Department of Conservation and Natural Resources in drafting these sections of the Act. The relevant sections of the Act are as follows:

- Sections 23, 23.1 and 23.2 of the Act makes such conforming and modernizing revisions to the Vehicle Code.

19 For example, the Vehicle Code contains provisions relating to perfection in multistate transactions that are inconsistent with the provisions of both Existing and Revised Article 9. Likewise, the Legislative Note to the Official Text of Revised 9-311(b) instructs legislatures of enacting states to make sure that each certificate of title statute provides that (x) perfection occurs upon receipt by the appropriate state official of a properly tendered application for a certificate of title on which the security interest is to be indicated, and (y) such perfection should not relate back to an earlier time (such as attachment of the security interest). A relation back provision may be inconsistent with the federal Bankruptcy Code and thus create a trap for the unwary. The regulations applicable to security interests on titled boats, issued under the Fish and Boat Code, however, currently do provide for such relation back in certain cases.
• Section 29(a) (tenth paragraph) of the Act repeals the Mobile Home Titling Act. When that act was enacted, the Vehicle Code did not require certificates of title to be issued for mobile homes. See 75 Pa.C.S. § 1102. In 1982 the Vehicle Code was amended to remove that exclusion, thus rendering the Mobile Home Titling Act largely redundant. Section 24 of the Act adds to the Vehicle Code one provision of the Mobile Home Titling Act uniquely applicable to mobile homes, relating to titling of mobile homes that are affixed to real property.

• Sections 19 and 20 of the Act make minor revisions to the provisions of the Fish and Boat Code applicable to boats covered by a certificate of title. The main operative provisions relating to security interests in such boats do not appear in the statute itself, however, but rather in the regulations issued by the Fish and Boat Commission at 58 Pa. Code § 98.101 et seq. The Committee, in conjunction with the Fish and Boat Commission, has prepared recommended amendments to those regulations.

• Sections 25, 26 and 27 of the Act amend SATVL to clarify that, with respect to ATVs, a security interest generally must be indicated on the certificate of title as a condition to or result of perfection, and hence that certificate of title will qualify as a “certificate of title” as defined in Revised 9102(a). These provisions also add to SATVL basic mechanical provisions spelling out explicitly the circumstances in which the Department of Conservation and Natural Resources will note a security interest on a certificate of title for an ATV and the effect of such notation.

It should also be noted that, pursuant to 75 Pa.C.S. §§ 1151-1155, the Department of Transportation is operating a pilot program to establish so-called “electronic certificates of title” for vehicles titled under the Vehicle Code. These “electronic certificates of title” are simply electronic records maintained by the Department of Transportation (or by a third-party recordkeeper on its behalf). It may be questioned whether this arrangement gives rise to a “certificate of title” as defined in Article 9. The Committee did not believe it appropriate to delay introduction of Revised Article 9 for the time that would be required to reach consensus among all affected interest groups as to whether this legal issue is indeed a serious one and, if so, the appropriate response. The Committee so decided because (i) Pennsylvania’s electronic certificate of title program is still in the pilot phase, (ii) the legal issue arises equally under Existing and Revised Article 9, and (iii) so far as the Committee has been able to ascertain the legal issue has received no attention to date in Pennsylvania or in any other state. The Committee has communicated to the Department of Transportation and two affected trade groups, the Pennsylvania Bankers Association and the Pennsylvania Automotive Association, the suggestion that this issue be studied and resolved before the program is expanded beyond the pilot phase.

VI. ANALYSIS OF SELECTED PROVISIONS OF THE PENNSYLVANIA UCC AFFECTED BY THE ACT

The Official Comments to Revised Article 9 describe its provisions in great detail on a section-by-section basis. The following comments describe features of the Pennsylvania enactment of Revised Article 9 under the Act that the Official Comments do not address. These comments fall into the following categories:

• Certain provisions of the Official Text of Revised Article 9 are left to be completed in whole or part by each enacting state, or are provided in alternative forms for enacting states to
choose among. This part VI identifies those provisions and describes how the Act completes them in Pennsylvania.

- As described in part I.F of this report, certain provisions of the Official Text of Revised Article 9 applicable in consumer transactions explicitly leave certain issues to be resolved by the courts of each state. This part VI identifies those provisions and describes current Pennsylvania case law on those issues.

- This part VI also addresses the few nonuniformities in, and other miscellaneous features of, the Pennsylvania enactment of Revised Article 9 under the Act.

- The Act makes minor conforming changes to provisions of the Pennsylvania enactment of Revised Article 9 that are not amended by the Revised Article 9 package. This part VI identifies those changes.

The Pennsylvania Comments set forth in Annex I to this report include further comments of permanent interest on certain sections of the Pennsylvania enactment of Revised Article 9 under the Act.

**Revised 1206.** The amendment to this section is not part of Revised Article 9. The amendment pertains to a nonuniform feature of Pennsylvania’s enactment of Sections 1206 and 2201. Those sections generally require certain agreements to be evidenced by a signed writing in order to be enforceable. Pennsylvania’s enactment of these sections contains a nonuniform exclusion, adopted in 1996 and patterned on similar nonuniform provisions adopted by New York, for “qualified financial contracts.” Among other things, the nonuniform exclusion has the effect of validating qualified financial contracts that are evidenced solely by electronic media if certain conditions are satisfied. Pennsylvania subsequently enacted the Electronic Transactions Act, Act of December 16, 1999, P.L. 971, No. 69 (“ETA”), which broadly validates electronic records and signatures. The ETA by its terms applies to transactions subject to various provisions of the UCC, including Sections 1206 and 2201. The present amendment to Revised 1206 clarifies that, as to qualified financial contracts, the validation of electronic records, signatures and transactions effected by ETA for purposes of Sections 1206 and 2201 is in addition to and not limited by the nonuniform provisions of Sections 1206 and 2201 applicable to qualified financial contracts. See also the Pennsylvania Comment to Section 1206 in Annex I.

**Revised 2104, 3103, 4105, 4A103, 4A105 and 8102.** The amendments to these sections are not part of Revised Article 9, but are made in order to conform the Pennsylvania enactment of these provisions to the Official Text of the UCC. Each of these provisions sets forth a list of defined terms, and the current Pennsylvania enactment of these provisions contains a preamble which includes the nonuniform phrase “unless the context clearly indicates otherwise”. The Act deletes that nonuniform phrase in each of those provisions. That nonuniform phrase is ordinarily used in definitional provisions under Pennsylvania legislative drafting style, but addition of that phrase is not appropriate in the UCC, the drafters of which deliberately declined to use similar language.

**Revised 9103.** Revised 9103 defines the term “purchase-money security interest” and provides related definitions and rules. Revised 9103(e) provides a rule for application of payments received in a transaction other than a consumer-goods transaction. Revised 9103(f) approves, for transactions other than consumer-goods transactions, what some cases have called the “dual status” rule, under which a security interest securing both a purchase-money obligation and a non-purchase money
obligation may be deemed a purchase-money security interest in part and a non-purchase-money security interest. Revised 9104(g) states that in a transaction other than a consumer-goods transaction, a secured party has the burden of proof when claiming a purchase-money security interest. Existing Article 9 was not perceived as providing a clear rule on the points stated in these three subsections (for consumer or nonconsumer transactions), and cases under Existing Article 9 in different states resolved these points in different ways. As part of the “consumer compromise” at the national level, noted in part I of this report, Revised 9103(h) excludes consumer-goods transactions from the rules set forth in these three subsections, and so continues to leave these points up to the courts in consumer-goods transactions.

The Act enacts the Official Text of this provision without substantive change. Courts applying Pennsylvania law have applied the dual status rule in consumer goods transactions almost without exception. Pristas v. Landaus of Plymouth, 742 F.2d 797 (3rd Cir. 1984); In re Breadingler, 116 B.R. 42 (Bankr. W.D. Pa. 1990); In re Trexler, 97 B.R. 206 (Bankr. E.D. Pa. 1989); Klanish v. Penn Furniture Co., 56 B.R. 184 (Bankr. W.D. Pa. 1986); In re Schwartz, 52 B.R. 314 (Bankr. E.D. Pa. 1985); Breakiron v. Montgomery Ward (In re Breakiron), 32 B.R. 400 (Bankr. W.D. Pa. 1983). But see Scott v. Landaus of Plymouth (In re Scott), 5 B.R. 37 (Bankr. M.D. Pa.) (applying "transformation" rule). If a debtor makes a payment on account of a secured obligation representing the purchase prices of several goods purchased by the debtor, and the debtor and secured party have not agreed on how the debtor’s payments are to be among those purchase prices, courts have applied the allocation formula in the Pennsylvania Goods and Services Installment Sales Act, 69 P.S. § 1101 et seq. See Landaus, 742 F.2d at 802; Trexler, 97 B.R. at 207. Courts applying Pennsylvania law have also concluded that the original purchase-money character of an obligation rides through a refinancing of the obligation. See Brendlinger, supra; Schwartz, supra.

Revised 9109(d)(14). This provision excludes from the scope of Revised Article 9 a security interest in “intangible transition property,” as defined in 66 Pa.C.S. §2812(g) (part of the Public Utility Code), to the extent that such security interest is governed by 66 Pa.C.S. §2812 rather than the UCC. That provision is nonuniform, but its inclusion does not reflect a change from current Pennsylvania law, because the cited statute by its terms overrides Article 9.

Revised 9201(b). Revised 9201(b) generally subordinates Revised Article 9 to consumer protection laws and regulatory statutes pertaining to extensions of credit in force in the enacting jurisdiction. The Official Text of Revised 9201(b) invites each enacting state to identify specifically each relevant statute. The Committee believes that such a specific identification is not necessary or useful. The Pennsylvania enactment of Revised 9201(b) instead phrases this provision to refer in general terms to Pennsylvania laws of the types described in the Official Text of Revised 9201(b). This approach is approved by the Enactment Guide.

Revised 9311(a)(2). Revised 9311 provides, in effect, that compliance with a certificate of title statute for titled goods is equivalent to the filing of a financing statement if notation of the secured

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20 Such cases frequently arise in two situations: when the debtor refinances a purchase money obligation, and when a debtor purchases under a revolving credit agreement (e.g., a charge card). Under Existing Article 9, some courts have held that such refinancings and revolving credit extensions “transform” the purchase money security interest in its entirety to a non-purchase money security interest. Other courts have held, as per the “dual status” rule, that a security interest can be purchase money in part and non-purchase money in part, and that purchase money status rides through a refinancing. The issue is often litigated when the debtor files for bankruptcy, because a debtor in bankruptcy may avoid a non-purchase money security interest in certain consumer goods if the security interest impairs an exemption to which the debtor would otherwise be entitled. See 11 U.S.C. § 522(f).
party's security interest on the certificate of title is a condition to or result of perfection of the secured party's security interest. The Official Text of Revised 9311(a)(2) invites each enacting state to identify specifically all certificate of title laws in that state. The Committee believes that it is not necessary or useful to make such a specific identification. The Pennsylvania enactment of Revised 9311(a)(2) instead refers in general terms to Pennsylvania certificate of title laws. This approach is approved by the Enactment Guide.

For a discussion of changes made to the Pennsylvania certificate of title laws by the Act, see part V of this report.

**Revised 9334(i), (j).** Revised 9334(i) provides that a perfected security interest in crops growing on real property prevails over a conflicting real estate mortgage, other real estate encumbrance or other real estate interest. The Official Text of Revised Article 9 contains an additional provision, Revised 9-334(j), which invites the enacting state to identify inconsistent statutes of the enacting state that are overridden by subsection (i). To the knowledge of the Committee no statute of the Commonwealth is inconsistent with subsection (i). Hence the Act omits subsection (j).

**Revised 9406(j) and 9408(e).** These two parallel provisions, left to be completed by each enacting state in the Official Text of Revised Article 9, are conveniently discussed together.

Revised 9406(d) invalidates contractual restrictions on the transfer of an account (other than a health-care-insurance receivable) or chattel paper. It also invalidates a contractual restriction on the transfer of a payment intangible or promissory note if the transfer is a security interest that secured an obligation rather than a sale of the payment intangible or promissory note. In addition, Revised 9406(f) invalidates statutory and other noncontractual legal prohibitions on transfers of accounts or chattel paper. The Official Text of Revised 9-406(j) instructs the legislature to list statutes validating contractual restrictions on transfer, or containing statutory restrictions on transfer, that conflict with Revised 9406(d) or (f), that are not to be overridden by Revised 9-406.

Revised 9408(a) partially invalidates (x) contractual restrictions on the sale of a payment intangible or promissory note, and (y) contractual restrictions on the transfer of a general intangible (other than a payment intangible) or health-care-insurance receivable. In addition, Revised 9408(c) partially invalidates statutory and other noncontractual legal prohibitions on the transfer of a general intangible (including a payment intangible), promissory note or health-care-insurance receivable. The invalidation provided in Revised 9408 is partial because, in general, the invalidation affects only restrictions on attachment and perfection of the security interest, but does not affect restrictions on the enforcement of the security interest. (See Revised 9408(d)). The Official Text of Revised 9-408(e) instructs the legislature to list statutes validating contractual restrictions on transfer, or containing statutory restrictions on transfer, that conflict with Revised 9408(a) or (c), and that are not to be overridden by Revised 9-408.

The Pennsylvania enactment of those provisions phrases Revised 9406(j)(1) and Revised 9408(e)(1) in general terms. Both subsections provide that the section to which the subsection belongs

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21 Among other reasons, if Revised 9311(a)(2) were written to identify specifically each relevant Pennsylvania certificate of title statute, that provision would have to be revised to reflect enactment of new certificate of title laws, repeal of existing certificate of title laws, and so on. Historically that has not been done: the equivalent provision in Pennsylvania’s enactment of Existing Article 9, Existing 9302(c)(2), lists only two of the four current Pennsylvania certificate of title laws. Failure to keep the cross-references to Pennsylvania’s certificate of title laws in Revised 9311(a)(2) current is at best a trap for the unwary, and at worst may raise substantive legal issues.
prevails over any inconsistent provision of any existing or future statute, rule or regulation of the Commonwealth unless the provision is contained in a statute of the Commonwealth, refers expressly to that section and states that the provision prevails over that section. This approach is approved by the Enactment Guide.

Revised 9406(j) provides a number of exceptions to the override of legal restrictions on assignment in subsection (f) of Revised 9406 and a more limited number of exceptions to the override of contractual restrictions on assignment in subsection (d) of Revised 9406. These exceptions are as follows:

Paragraph (2) of Revised 9406(j) provides that subsection (f) does not apply to an account or chattel paper if the account debtor is the Commonwealth.

Paragraph (3) of Revised 9406(j) provides that subsection (f) does not apply to the following:

(i) A claim or right to receive benefits under a workers' compensation act as compensation for personal injury or sickness, including a claim or right to receive benefits under the act of June 2, 1915 (P.L. 736, No. 338), known as the Workers' Compensation Act. Section 318 of the Worker's Compensation Act, 77 P.S. § 621, prohibits assignment of claims or payments of workmen’s compensation rights

(ii) The act of June 21, 1939 (P.L. 566, No. 284), known as The Pennsylvania Occupational Disease Act. Section 318 of that act, 77 P.S. § 1418, prohibits assignment of claims or payments under that act.

(iii) Section 306 of the act of August 26, 1971 (P.L. 351, No. 91), known as the State Lottery Law. Section 306 of the State Lottery Law, 72 P.S. § 3761-306, sets forth certain procedures that must be followed before a lottery winner may assign his or her right to receive payments.

Paragraph (4) of Revised 9406(j) provides that subsections (d) and (f) do not apply to a claim or right to receive benefits from a special needs trust described in section 1917(d)(4) of the Social Security Act (49 Stat. 620, 42 U.S.C. § 1396P(D)(4)) (which relates to eligibility for Medicaid benefits).

Paragraph (5) of Revised 9406(j) provides that the limitations on restrictions of assignments contained in Revised 9406 (hence including both subsections (d) and (f)) are inapplicable to transfers of structured settlement payment rights pursuant to the Act of February 11, 2000 (P.L. 1, No. 1), known as the Structured Settlement Protection Act (“SSPA”). The SSPA sets forth procedures that must be followed before the beneficiary of a structured settlement of a personal injury, sickness or workers' compensation claim may assign his or her right to receive payments.

Revised 9408(e) incorporates many of these exceptions into Revised 9408. Thus, paragraph (2) of 9408(e) provides that the override of legal restrictions on assignment contained in subsection (c) of Revised 9408 does not apply to the provisions, claims and rights listed in paragraph (3) of Revised 9406(j). Paragraph (3) of Revised 9408(e) provides that the overrides of contractual and legal restrictions on assignment contained in subsections (a) and (c) of Revised 9408 do not apply to the claims and rights listed in paragraph (4) of Revised 9406(j). Finally, paragraph (4) of Revised 9408(e) excepts
from all of the overrides on restrictions on assignment (thus including both the overrides of contractual and legal restrictions on assignment contained in subsections (a) and (c)) transfers of structured settlement payment rights under the SSPA.

For the most part, the reason why Revised 9406(j) and Revised 9408(e) preserve from override the restrictions on assignment in the particular statutes listed in those sections is because those restrictions on assignment are designed to protect the assignor, rather than the obligor of the obligation in question. The carve-outs in paragraphs (3), (4) and (5) of Revised 9406(j), and the parallel carve-outs in Revised 9408(e), were for the most part added at the suggestion of representatives of the insurance industry and the structured settlement factoring industry and parallel similar provisions in the enactment of Revised 9406 and Revised 9408 in several other states.

It should be noted that certain of the matters referred to in paragraphs (3), (4) and (5) or Revised 9406(j), and in the parallel carve-outs in Revised 9408(e), may be excluded from the scope of Revised Article 9 anyway. For example, assignments of claims or payments referred to in paragraphs (3)(i) (workers’ compensation) and (3)(ii) (Pennsylvania Occupational Disease Act) of Revised 9406(j) may be excluded from Revised Article 9 by Revised 9109(d)(3), which provides that Article 9 does not apply to an assignment of a claim for compensation of an employee. Likewise, assignment of a right under the SSPA described in paragraph (5) of Revised 9406(j) may be excluded from Revised Article 9 for at least two reasons. First, the SSPA declares that “[a]ny transfer made or agreed to under this act shall be considered to be a consumer transaction” (see SSPA § 1, “transfer”), and SSPA § 7 further provides that a violation of that Act is a violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law. Arguably, therefore, such an assignment is not subject to Revised 9406 because, under Revised 9201, the provisions of Article 9 are subject to any consumer protection statute. Second, to the extent that the structured settlement is embodied in a judgment, assignment of rights thereunder may be excluded from Revised Article 9 by Revised 9109(d)(9), which provides that Article 9 does not generally apply to an assignment of a right represented by a judgment. 22

Revised 9501 through 9527 (Chapter 95 of Title 13): Filing Office Operations. Part 5 of Revised Article 9, which in the Pennsylvania enactment is to be Chapter 95 of Title 13, sets forth the details of the system for filing financing statements with public filing offices in order to perfect security interests. At numerous places throughout Part 5, the Official Text sets forth alternative language for enacting states to choose from or blanks for them to complete, depending on the operational details of the filing systems used by the central state filing office and the county real estate filing offices. These provisions are as follows:

Revised 9501(a)(2), (b). These subsections have been completed to specify the Department of State as being Pennsylvania's central filing office. This is, of course, consistent with current Pennsylvania law, per Existing 9401(a).

Revised 9502(b). The Official Text of Revised 9-502(b) requires that real-property-related financing statements must be filed “[for record].” The bracketed phrase is optional. That optional phrase is omitted in the Pennsylvania enactment of Revised 9502(b). Similar optional

22 Stylistically it might have been preferable to follow the pattern contemplated by Revised 9406(j)(1) and 9408(e)(1) and amend the statutes excepted from the operation of (for instance) Revised 9406(f) and Revised 9408(c) to provide that they prevail over Revised 9406(f) and 9408(c). However, the Act cannot directly amend those statutes because they are not in the Pennsylvania Consolidated Statutes.
language in the Official Text of the predecessor provision, Existing 9-402(5), is omitted in Pennsylvania's enactment of that provision, Existing 9402(e).

Revised 9502(c). The Official Text of Revised 9-502(c) states that a mortgage filed as a financing statement must be “[duly]” recorded. The bracketed word is optional, and is included in the Pennsylvania enactment of Revised 9502(c). Similar optional language is included in the Official Text of the predecessor provision, Existing 9-402(6), and is included in Pennsylvania's enactment of that provision, Existing 9402(f).

Revised 9512(a), 9518(b), 9519(f), 9522(a). The Official Text of each of these provisions contains an alternative “Version A” and “Version B.” The two versions differ in the degree of detail that must be stated in an amendment to an initial financing statement filed with a filing office for real-property-related financing statements (in Pennsylvania, a county recorder of deeds). Under Version A, the amendment may reference the initial financing statement by the debtor's name and the file number alone. Under Version B, the amendment must also include the date or time at which the initial financing statement was filed. The Pennsylvania enactment in each case uses Version A.

Revised 9519(b). This provision has been completed to require the file number assigned to each financing statement to contain a “check digit” commencing January 1, 2002. This requirement applies to the Department of State and does not apply to Pennsylvania recorders of deeds, per the Pennsylvania enactment of Revised 9519(i).

Revised 9519(d). With respect to real-property-related financing statements, the Official Text of Revised 9-519(d) contains optional bracketed language requiring such financing statements to be filed “[of record]”. The Pennsylvania enactment, Revised 9519(d), does not include that optional language. The Official Text of the predecessor provision, Existing 9-403(7), contained similar optional language which is similarly omitted in the Pennsylvania enactment, Existing 9403(f).

Revised 9519(i). This provision has been completed to provide that Pennsylvania recorders of deeds need not (x) implement a check digit verification system in their file numbers per Revised 9519(b), or (y) adhere to the performance standard set forth in Revised 9519(h) for indexing, maintaining and retrieving filing information.

Revised 9520(b). This provision has been completed to provide that Pennsylvania recorders of deeds need not adhere to the performance standard set forth in this subsection for refusing to accept a record for filing.

Revised 9521(a), (b). The Official Text sets forth “safe-harbor” forms of financing statement and amendment that filing offices are required to accept. For simplicity and clarity, the Pennsylvania enactment incorporates by reference the forms approved by NCCUSL-ALI and included in the final Official Text of Revised Article 9, rather than reproducing those forms in full in the Pennsylvania Consolidated Statutes. This approach is endorsed by the Enactment Guide.

Revised 9523(c)(1)(A). This provision has been completed to provide that a filing office is required to honor search requests for a debtor limited to a particular address.

Revised 9523(d). This provision has been completed to provide that a filing office responding to a search request must, at the request of the person requesting such search, issue the response in the form of a written certificate.
Revised 9523(e). This provision has been completed to provide that Pennsylvania recorders of deeds need not comply with the performance standard for search requests set forth in this section.

Revised 9523(f). This provision has been completed to exclude Pennsylvania recorders of deeds from the requirement that filing offices must offer to sell or license filing information on a nonexclusive basis to the public at least weekly.

Revised 9525. This provision, which sets forth filing and search fees, is enacted in a substantially nonuniform way by the Act, as discussed in part III.C.3 of this report.

Revised 9526(a). This provision has been completed to provide that filing-office rules are to be promulgated by the Department of State.

Revised 9527. The Official Text of this provision contemplates that an appropriate governmental official or agency will report annually to the governor and/or legislature of the enacting state as to the operations of the state’s filing system. The Act enacts this provision to require the Department of State to issue such a report to the Governor and the General Assembly by October 31st of every even-numbered year.

Revised 9518(d). Revised 9518(d) is a nonuniform provision added to the Pennsylvania enactment at the suggestion of the Department of State and the Governor’s office. It is addressed to “bogus filings” – that is, financing statements filed against a debtor without authorization by the debtor for purposes of harassment. Current law requires a court order before a bogus filing may be stricken from the public record. Revised Article 9 includes a number of provisions aimed at bogus filings. The most important provisions, Revised 9509(d) and Revised 9513(a)(2), give the victim of a bogus filing a swift and cheap way to render such filings legally ineffective without court approval. In addition, the victim has a damage remedy against the person who made the bogus filing, per Revised 9625.

Pennsylvania’s nonuniform Revised 9518(d) supplements the scheme of the Official Text by authorizing the Department of State to conduct an administrative hearing to determine if an initial financing statement was fraudulently filed. If the Department determines an initial financing statement to have been fraudulently filed, the Department is authorized to record that determination in the UCC filing records. The effect of that determination is to create a rebuttable presumption that the initial financing statement in question is ineffective. If the Department’s determination is appealed to Commonwealth Court and is affirmed, the initial financing statement in question is ineffective. Revised 9518(d) explicitly preserves the other rights and remedies that the victim of a bogus filing may have, including the right to terminate such filings without court approval pursuant to Revised 9509(d) and Revised 9513(a)(2), and the damage remedy provided by Revised 9625.

Revised 9519(h), 9520(b) and 9523(e): Nonuniform Changes to Filing Office Performance Standards. Several provisions of Revised Article 9 require the filing office to perform certain acts within a specified period of time, and the Pennsylvania enactment makes nonuniform changes to three of those provisions. The Official Text of Revised 9519(h) requires the filing office to process and index filed records within two business days; the Pennsylvania enactment extends that period to five business days. Likewise, the Official Text of Revised 9520(b) requires a filing office that refuses to accept a filing to so advise the filer within two business days after the filing office received the filing; the Pennsylvania enactment extends that period to five business days. Finally, the Official Text of Revised 9523(e) provides that a filing office must respond to a search request within two business days after receiving the request; the Pennsylvania enactment extends that period to five business days. The periods
set forth in these provisions of the Pennsylvania enactment apply only to the Department of State, and do not apply to county recorders of deeds.

The Official Text of Revised 9523(c)(1) in effect requires a filing office when responding to a search request to use an “as of” date for the search that is not earlier than three business days before the filing office received the search request. In order for that period to mesh with Pennsylvania’s nonuniform period for processing and indexing filed records under Revised 9519(h), which as described above is three business days longer than the period specified in the Official Text, it would appear that the period in Revised 9523(c)(1) should also have been extended by three business days, to six business days. However, the Pennsylvania enactment of Revised 9523(c)(1) adheres to the Official Text and does not make that change. This appears to be an oversight and should be corrected by a technical amendment.

Revised 9612. Revised Article 9, like Existing Article 9, generally requires a secured party who effects a foreclosure sale to send to the debtor (and others) a reasonable advance notice of the sale. Revised 9612, a safe-harbor provision having no predecessor in Existing Article 9, states in effect that in a non-consumer transaction, a notification of sale sent after default and at least 10 days before the earliest time of sale set forth in the notice is deemed to be sent within a reasonable time. As part of the “consumer compromise” at the national level, this safe harbor by its terms is confined to non-consumer transactions, so determination of the reasonableness of the time at which notice is given is always left to the courts in consumer transactions.

The Act enacts the Official Text of this provision without substantive change. Currently there is little case law in Pennsylvania (or, indeed, in other states) addressing the issue of timeliness of notice in consumer transactions. (This may be because where notice is an issue, the secured party usually has failed to give any notice at all.) If the collateral at issue is a motor vehicle subject to an installment sale contract, the Pennsylvania Motor Vehicle Sales Finance Act, 69 P.S. § 623, requires that the secured party give the debtor notice of sale at least 15 days prior to the intended disposition. See also Beneficial Consumer Discount Co. v. Savoy, 436 A.2d 687 (1981) (notice given 15 days before sale was reasonable notice of foreclosure sale of automobile).

Revised 9617. Revised 9617 sets forth the rights of transferees of collateral when the collateral is disposed of by the secured party following a default by the debtor. Generally all subordinate security interests and liens are discharged by the secured party's disposition. The Official Text invites enacting states to refer in Revised 9617(a)(3) to any statutory lien in the state that should survive a foreclosure disposition by a secured party, even though the lien is subordinate to the secured party's security interest. The Act does not contain such a reference, as the Committee is not aware of any statutory lien in Pennsylvania that should survive a foreclosure disposition even though subordinate to the secured party's security interest.

Revised 9626. Revised 9626, which applies only to nonconsumer transactions, deals with the debtor's damages in the event that the secured party has foreclosed on collateral, or otherwise enforced its security interest, and an issue arises as to whether that foreclosure violated the rules of Article 9. Under Revised 9626, the secured party need not prove compliance with the rules of Article 9 as part of its prima facie case, but if the debtor (or certain other persons) raise the issue, the secured party bears the burden of proving that the foreclosure complied. If the secured party is unable to meet this burden, then the so-called “rebuttable presumption” rule applies. In general, the debtor is credited with the greater of the actual proceeds of the disposition or the proceeds that would have been realized had the secured party complied with the relevant provisions. Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, the amount that a complying disposition would have yielded is deemed to be equal to the amount of the secured obligation, together
with expenses and attorney's fees; hence the secured party may not recover any deficiency unless it meets this burden. As part of the “consumer compromise” at the national level, this rule (which codifies the approach taken by many but not all courts nationwide under Existing Article 9) was written to apply to nonconsumer transactions alone, and the issue of whether a secured party who makes a foreclosure sale in violation of Article 9 may still claim a deficiency is left to the courts in consumer transactions.


**Revised 9701 through 9710 (Chapter 97 of Title 13): Transition Rules Generally.**

This chapter, which enacts Part 7 of the Official Text (with certain nonuniform changes discussed herein), is dedicated to the complex transition from Existing Article 9 to Revised Article 9. The Official Text of Part 7 repeatedly uses two bracketed phrases, in the expectation that each enacting jurisdiction will replace them with terminology appropriate in that jurisdiction. First, the Official Text throughout uses the phrase “this [Act]”. The intended referent of that phrase, however, is not the Act enacting Revised Article 9, but rather the UCC as revised by the Act. Second, at several places the Official Text refers to specific sections of Existing Article 9, in brackets. Thus, for example, the Official Text of Revised 9-705(c) provides for the survival of a pre-effective date financing statement which “is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103]”.

The Pennsylvania enactment of this chapter addresses these bracketed phrases in Part 7 of the Official Text as follows:

First, it adds a new Section 9700 defining two terms, “Existing Division 9” and “Revised Division 9”, which (paraphrased) are defined to mean Title 13 of the Pennsylvania Consolidated Statutes (that is, the UCC as in effect in Pennsylvania) before and after giving effect to the Act, respectively. These terms are defined to include the whole of Title 13, not merely Division 9, in order to include the conforming changes which the Revised Article 9 revision package makes to UCC provisions outside of Article 9.23

Second, bracketed references in the Official Text to provisions of Existing Article 9 are completed by referring to the defined term “Existing Division 9”. Thus, for example, in the Pennsylvania enactment of Revised 9705(c), the passage quoted above reads as follows: “is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in section 9103 of Existing Division 9 (relating to [omitted]).”

Third, references in the Official Text to “this [Act]” are completed by referring to “Revised Article 9”.

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23 However, Division 5 (other than §5118) is excluded from these defined terms. That is because the Act enacts Revised Article 5 as well as Revised Article 9. The transitional provisions properly applicable to Revised Article 5 are not those of Part 7 of Revised Article 9, but rather the uncodified transitional provisions in the 1995 Official Text of Revised Article 5, which the Act enacts in Section 28. Section 5118 is properly treated as part of Revised Article 9 for transitional purposes because that section was added to Article 5 by the Revised Article 9.
Finally, the Official Text of this chapter contains several references to specific sections of Revised Article 9. Thus, for example, the Official Text of Revised 9-702(b)(2) reads as follows: “remains enforceable thereafter only if the security interest becomes enforceable under Section 9-203 before the year expires; and”. Because this chapter, as enacted, also contains several references to sections of Existing Article 9, which should not be confused with these references to sections of Revised Article 9, for clarity and parallelism the Pennsylvania enactment of this chapter identifies as such each reference to a section of Revised Division 9. Thus, the Pennsylvania enactment of Revised 9702(b) reads as follows: “remains enforceable thereafter only if the security interest becomes enforceable under section 9203 of Revised Division 9 (relating to [omitted]) before the year expires; and”.

The Committee believes that the foregoing drafting techniques implement the intention of the Official Text without substantive change.

**Revised 9707(e)(2).** Revised 9707 deals with the ways in which a financing statement filed before the effective date of Revised Article 9 may be amended (which term includes termination) after the effective date. This provision was a late addition to the Official Text of Revised Article 9, having been added in a January 2000 erratum. The Official Text of this provision seemingly would require a Pennsylvania prothonotary after the effective date to accept a termination statement relating to a pre-effective-date financing statement on file with the prothonotary; however, a prothonotary would not be empowered to accept amendments of any other type. That is contrary to the thrust of Revised Article 9 and related provisions in the Enactment Guide as constituted before that erratum was issued, which had the effect of providing that local filing officers such as Pennsylvania prothonotaries would not be empowered to accept any amendments of any nature after the effective date. Transitional issues such as these defy clean resolution, but the Committee is of the view that it is wiser as a policy matter to adhere to the scheme originally contemplated by Revised Article 9 and make a clean break, so that prothonotaries must cease to accept any further Article 9 filings the effective date. Nonuniform Revised 9707(e)(2) and nonuniform Revised 9710 implement that judgment. For further discussion, see the Pennsylvania Comments to Revised 9707 in Annex I of this report and part III.D of this report.

**Revised 9710.** This section is nonuniform. It relates to the continuing limited operation of prothonotaries' offices with respect to UCC filings made with them before the effective date of Revised Article 9. For further discussion, see the Pennsylvania Comment to Revised 9710 in Annex I of this report and part III.D of this report.

**Production Money Security Interests.** Appendix II to the Official Text of Revised Article 9 contains optional provisions setting forth a so-called “production-money security interest,” held by a secured party who gives new value used in the production of crops. These optional provisions essentially grant a superpriority in the resulting crops to the holder of a production money security interest, so that such a holder will (for example) generally have priority in such crops over a prior

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24 It has been suggested that the Official Text of Revised 9-707(e) can be interpreted so as not to require a Pennsylvania prothonotary after the effective date to accept a termination statement relating to a pre-effective date financing statement on file with the prothonotary. That interpretation depends on reading Revised 9-707(e) as being applicable only to "filing offices" as defined in Revised Article 9, which in Pennsylvania would include only the Department of State and the county recorders of deeds. However, the Official Text of Revised 9-707(e) pointedly does not use the term "filing office," but rather the undefined term "office," and the most natural reading of that term would include any office in which pre-effective-date financing statements may be on file in Pennsylvania.
perfected lender who does not hold a production money security interest. The Act does not include these optional provisions.

VII. SECTION-BY-SECTION ANALYSIS OF THE ACT

Section 1. The section sets forth a short title for the Act.

Section 2. This section updates a cross-reference to provisions of Article 9 in 12 Pa.C.S. § 5108(e) to reflect the changed section numbers in Revised Article 9.

Section 3. This section enacts a new provision, 12 Pa.C.S. § 9801, to repeal Pennsylvania’s common law “assembled industrial plant doctrine.” See the Pennsylvania Comment to 12 Pa.C.S. § 9801 in Annex I for further discussion.

Sections 4 through 16. These sections enact the revisions to the Pennsylvania UCC, Title 13 of the Pennsylvania Consolidated Statutes, described in the bulk of this report.

Sections 17, 18, 18.1 and 18.2. These sections amend portions of the Corporation Bureau and UCC Fee Law, 15 Pa.C.S. §§ 151-155 (“CBUFL”). At present, the CBUFL is primarily devoted to setting forth the fee schedule for services performed by the Department of State (both pursuant to the UCC and other laws), and it also sets forth the fee schedule for UCC services performed by prothonotaries and recorders of deeds to the extent not displaced by other laws. Section 18 amends CBUFL § 151 to reflect that the UCC fees set forth in the CBUFL will be set forth in Revised 9525 and regulations promulgated by the Department of State pursuant to Revised 9525. Section 18.1 makes conforming changes to CBUFL § 153 which are discussed in part III.C.3 of this report. Section 18.2 makes conforming changes to CBUFL §§ 154 and 155. Section 17 makes a conforming change to a caption.

Sections 19, 20. These sections amend provisions of the Fish and Boat Code relating to security interests in boats covered by a certificate of title, in 30 Pa.C.S., chapter 77. See the discussion of certificate of title laws in part V of this report.

Section 21. This section makes a conforming amendment to 42 Pa.C.S. § 1725, which sets forth the fee schedule for prothonotaries in counties of the first class, by adding language to reflect that UCC fees will be as set forth in Revised 9525.

Section 22. This section updates a cross-reference to provisions of Article 9 in 66 Pa.C.S. § 2812(d) to reflect the changed section numbers in Revised Article 9.

Sections 23, 24. These sections amend provisions of the Vehicle Code relating to security interests in vehicles covered by a certificate of title, in 75 Pa.C.S., chapter 11, and add a provision pertaining to mobile homes affixed to real estate. See the discussion of certificate of title laws in part V of this report.

Sections 25, 26, 27. These sections amend provisions of the Snowmobile and All-Terrain Vehicle Law relating to security interests in all-terrain vehicles covered by a certificate of title, in 75 Pa.C.S., chapter 77. See the discussion of certificate of title laws in part V of this report.
Section 28. This section enacts, as Pennsylvania law, the uncodified transition provisions set forth in the 1995 Official Text of Revised Article 5. These transition provisions are intended to apply only to Pennsylvania’s enactment of Revised Article 5 pursuant to the Act; they are not intended to apply to the enactment of Revised Article 9, which contains its own transition provisions (see the comments to Chapter 97 of Title 13 of the Pennsylvania Consolidated Statutes in part VI of this report). Hence the preamble to this section states that its provisions apply only to Pennsylvania’s enactment of Article 5 (that is, Division 5 of Title 13 of the Pennsylvania Consolidated Statutes), except for section 5118 (which is part of the Revised Article 9 revision package).

Section 29(a) (Repealers).


Third Paragraph. This paragraph repeals an obsolete law that requires a legend to be placed on a negotiable instrument given for patent rights. Act of April 12, 1872, P.L. 60, No. 47 (56 P.S. §§ 9, 9a).

Fourth Paragraph. This paragraph repeals the Act of June 12, 1919, P.L. 476, No. 240 (16 P.S. § 11411), which sets forth the fee schedule for recorders of deeds in counties of the second class, insofar as it is inconsistent with Revised 9525. Revised 9525 preserves existing laws on such fees but gives the Department of State power to vary such fees by regulation.

Fifth Paragraph. This paragraph repeals an obsolete law relating to federal farm relief loans and security therefor. Act of March 28, 1931 P.L. 11, No. 9 (3 P.S. §§ 761-762).

Sixth Paragraph. This paragraph repeals an obsolete law relating to borrowing of funds from federal agencies and security therefor. Act of July 15, 1936, P.L. (First Ex. Sess.) 47, No. 22 (21 P.S. §§ 841-845).

Seventh Paragraph. This paragraph repeals the Act of April 20, 1949, P.L. 644, No. 143 (16 P.S. § 7629), which sets forth the fee schedule for recorders of deeds in counties of the first class, insofar as it is inconsistent with Revised 9525. Revised 9525 preserves existing laws on such fees but gives the Department of State power to vary such fees by regulation.

Eighth and Ninth Paragraphs. These paragraphs repeal two similar obsolete laws, one relating to chattel mortgages made before July 1, 1954 (which was the effective date of the initial enactment of the Uniform Commercial Code in Pennsylvania) and the other relating to conditional sales made before that date. Act of January 24, 1956, P.L. (1955) 931, No. 288 (21 P.S. §§ 941.1-941.13); Act of February 28, 1956, P.L. (1955) 1147, No. 358 (69 P.S. §§ 505.1-505.19). “Chattel mortgage” and “conditional sale” were pre-UCC methods of taking a lien in certain kinds of personal property. Before the enactment of the UCC in 1953, Pennsylvania had both a chattel mortgage statute and a conditional sale statute, and both were repealed by the law enacting the UCC. The two 1956 laws are in effect belated transitional provisions that allow chattel mortgages and conditional sales made before the effective date of the UCC to be continued after that date under the repealed laws. Specifically, the two 1956 laws contemplate that filings made with a county prothonotary under the chattel mortgage statute or conditional sales statute may be kept in force indefinitely by periodic renewal filings in the separate dockets maintained by prothonotaries under the chattel mortgage and conditional sale statutes.
These two laws are obsolete. Secured parties have had fifty years to file financing statements as required under the UCC in lieu of relying on renewal of liens noted in these ancient dockets. Filing officers in prothonotaries’ offices queried by the Committee have stated that they are not aware of any renewal filing having been made in these ancient dockets within institutional memory.

**Tenth Paragraph.** This paragraph repeals the Mobile Home Titling Act, Act of July 25, 1977, P.L. 95, No. 35. See the discussion of certificate of title laws in part V of this report.

**Eleventh Paragraph.** This paragraph in effect amends the Act of April 8, 1982, P.L. 303, No. 85 (42 P.S. § 21042), which sets forth the fee schedule for prothonotaries in counties of the second class. The amendments repeal the portions of that act that set forth fees for UCC services to the extent inconsistent with Revised 9525. Revised 9525 preserves existing laws on such fees but gives the Department of State power to vary such fees by regulation.

**Twelfth Paragraph.** This paragraph in effect amends the Act of April 8, 1982, P.L. 310, No. 87 (42 P.S. § 21051), which sets forth the fee schedule for recorders of deeds in counties of classes second A and third through eighth. The amendments repeal the portions of that act that set forth fees for UCC services to the extent inconsistent with Revised 9525. Revised 9525 preserves existing laws on such fees but gives the Department of State power to vary those laws by regulation.

**Section 29(b) (Repealers).** Section 29(b) is a general repealer.

**Section 30.** This section sets an effective date of July 1, 2001 for all of the operative provisions of the Act, that date being the uniform effective date for Revised Article 9 set forth in the Official Text of Revised Article 9. Hence the Act adopts the same effective date for all of its operative provisions, including the provisions adopting Revised Article 5. For the transition provisions applicable to Revised Article 5, see Section 28 of the Act. For the transition provisions applicable to Revised Article 9, see Chapter 97 of Title 13 as amended by the Act. Section 30 also provides that the Act takes effect immediately with respect to Revised 9525(d), which requires the Department of State to promulgate regulations varying the UCC filing fees to be charged by Pennsylvania filing offices within 90 days after the effective date of that section. Section 30 further provides that the addition of 15 Pa.C.S. §153(d), relating to adjustments to fees at the county level, will take effect in 90 days.

[End]
ANNEX I

PENNSYLVANIA COMMENTS TO THE ACT

Title 12, Pennsylvania Consolidated Statutes

Section 9801. Assembled industrial plant doctrine abolished.

Pennsylvania Comment (2001). The assembled industrial plant doctrine is an archaic common law rule unique, or nearly unique, to Pennsylvania. The doctrine provides that all goods essential to operation of an “industrial plant” (construed broadly to include virtually any manufacturing or commercial establishment), whether or not attached to the premises, are deemed to be fixtures and hence subject to the lien of a mortgage on the premises. The Pennsylvania Supreme Court created the doctrine in Voorhis v. Freeman, 2 Watts & Serg. 116 (Pa. 1841) and applied it in many later cases, including among others First Nat'l Bank v. Reichneder, 371 Pa. 463, 91 A.2d 277 (1952), Land Title Bank & Trust Co. v. Stout, 339 Pa. 302, 14 A.2d 282 (1940), Central Lithograph Co. v. Eatmor Chocolate Co., 316 Pa. 300, 175 A. 697 (1934), and Commonwealth Trust Co. v. Harkins, 312 Pa. 402, 167 A. 278 (1933). At the time the doctrine was created it was difficult or impossible under Pennsylvania law to grant a nonpossessory lien in chattels. The doctrine was a way of accommodating the need for such a security device, by allowing such a lien to be granted as an incident of a mortgage on the related real estate. But when later legal developments created simple ways to grant a nonpossessory lien in chattels -- and certainly by the time Article 9 of the Uniform Commercial Code (enacted in Pennsylvania in 1953) rationalized and simplified the law pertaining to such liens -- the rationale for the doctrine disappeared. Indeed, Grant Gilmore, co-drafter of Article 9, was of the view that Article 9 itself abrogated the doctrine. See 2 Grant Gilmore, Security Interests in Personal Property § 30.4, at 815 (1965). Courts applying Pennsylvania law have nevertheless continued to apply the doctrine after the enactment of Article 9. See, e.g., Kaplan v. Kaplan, 422 Pa. Super. 215, 619 A.2d 322 (1993); Griffin v. Falcon Oil Co., 182 B.R. 8 (Bankr. M.D. Pa. 1995).

Subsection (a) of this Section 9801 unequivocally abolishes the doctrine. Pursuant to subsection (c), the abolition effected by subsection (a) has prospective effect only, but this section takes no position on whether the doctrine is properly viewed as being part of Pennsylvania law before the effective date of this section. Subsection (b) makes clear that the abolition of the assembled industrial plant doctrine has no effect on the assembled economic unit doctrine applied in the context of eminent domain, as per such cases as Singer v. Redevelopment Authority, 437 Pa. 55, 261 A.2d 594 (1970) and Denes v. Pennsylvania Turnpike Commission, 547 Pa. 152, 689 A.2d 219 (1997).

Title 13, Pennsylvania Consolidated Statutes

Section 1206. Statute of frauds for kinds of personal property not otherwise covered.

[Note: the following comment is in addition to, and does not replace, the 1996 Pennsylvania Comment.]

Pennsylvania Comment (2001). Pennsylvania’s nonuniform Section 1206(c) has been amended by addition of a new paragraph (6), which states explicitly a point implicit in paragraph (5): namely, that the provisions of subsection (c) and the related nonuniform Section 2201(d) are cumulative with, and do not limit the application to qualified financial contracts of, any other laws validating records, signatures or transactions made or evidenced by nontraditional media. At present, one such law is the Electronic Transactions Act, Act of December 16, 1999, P.L. 971, No. 69 (the “ETA”).

The ETA is a statute of very general applicability and applies to a class of transactions far broader than qualified financial contracts. Furthermore, the ETA by its terms applies to transactions governed by
numerous provisions of the Pennsylvania Uniform Commercial Code in addition to sections 1206 and 2201. Section 1206(c)(6) thus is solely for purposes of clarity. The ETA applies to all of the provisions of the Pennsylvania Uniform Commercial Code that, by the terms of the ETA, are subject to the ETA, whether or not those other provisions refer to other statutes dealing with nontraditional media.

Section 5101. Short title.

Pennsylvania Comment (2001). The Pennsylvania Comments to the Pennsylvania enactment of the 1995 Official Text of Revised Article 5 were prepared by a subcommittee of the Business Law Section of the Pennsylvania Bar Association, referred to in the Pennsylvania Comments as the "Pennsylvania Article 5 Committee." The Pennsylvania Comments, like the Official Comments promulgated with the 1995 Official Text, are part of the legislative history of the Pennsylvania enactment under 1 Pa.C.S. § 1939 (relating to use of comments and reports). The Pennsylvania Comments supplement the Official Comments, and supersede the Official Comments to the extent of any inconsistency between them.

Section 5102. Definitions.

Pennsylvania Comment (2001). "Document" and "Record." The 1995 Official Text introduced the terms "document" and "record," which expressly deal with electronic and other paperless media. The 1995 Official Text did not, however, alter the definitions of the terms "written" and "writing" in Section 1-201(46) (13 Pa.C.S. § 1201), which have remained unchanged since the 1962 Official Text. The introduction of these new terms might be read to imply that, as used in Revised Article 5 and the Official Comments thereto, the older terms "written" and "writing" refer exclusively to paper and similar traditional media. No inference should be drawn that the meaning of the terms "writing" or "written" is necessarily so limited outside Revised Article 5. This point is similarly emphasized by the Pennsylvania Comment (1996) to Pennsylvania's nonuniform enactment of Section 1-206, 13 Pa.C.S. § 1206.

Section 5103. Scope.

Pennsylvania Comment (2001). Pennsylvania rejects the fourth sentence of the fourth paragraph of Official Comment 2 to Section 5-103 ("A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in ‘bad faith’ or committed “gross negligence” is ineffective under Section 5-103(c).") and similarly rejects the third sentence of the first paragraph of Official Comment 3 to Section 5-116 insofar as it implies the unenforceability of a provision in a reimbursement agreement that frees an issuer from liability unless it is "grossly negligent." These portions of the Official Comments do not properly apply Sections 1102(c) and 5103(c). An agreement between an issuer and applicant to limit the issuer's liability to circumstances in which the issuer committed "gross negligence" is a specification of a standard by which performance is to be measured which is not manifestly unreasonably under Section 1102(c), and it is not a provision "generally excuse liability" or "generally limiting remedies" as proscribed by Section 5103(c).
Section 5108. Issuer’s rights and obligations.


1. The 1995 Official Text of Section 5-108(e) includes two sentences reading as follows: "Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice." The Pennsylvania enactment of that provision, Section 5108(e), does not include those two sentences. This nonuniform change parallels a similar nonuniform change in the New York enactment of that provision. As a result of this change, the fifth paragraph of Official Comment 1 to this section ("Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as American Coleman Co. v. Intrawest Bank, 887 F.2d 1389 (10th Cir. 1989), where summary judgment was granted.") is not applicable in Pennsylvania.

2. The 1995 Official Text of Section 5-108(i)(5) does not discharge an issuer from its obligation on a letter of credit if the issuer honored a presentation in which a required signature of a beneficiary was forged. The Pennsylvania enactment of that provision, Section 5108(i)(5), rejects that rule. Thus, under the Pennsylvania enactment an issuing or confirming bank is discharged upon its honor of a presentation as permitted or required by this Article, notwithstanding that a required signature of the beneficiary on a presented document was forged. For that reason, Official Comment 13 to Section 5108 is not applicable in Pennsylvania. The rights and duties of the issuer and applicant in the event of a forged beneficiary's signature may be subject to the rules set forth in Section 5109.

3. The final sentence of the first paragraph of Official Comment 7 to Section 5-108 states, "A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension." This sentence should apply even to a letter of credit which by its terms is subject to the UCP, or to other rules of custom and practice that prescribe a time within which the issuer must honor or dishonor. For example, Article 13 of the UCP sets forth essentially the same time for honor or dishonor as is established by Section 5108(b). If a letter of credit is subject to the UCP, Article 13 becomes a term of the letter of credit (see Section 5116(c) and Official Comment 2 to Section 5-103), and so it might be asserted that, in such a case, extension of time is an amendment to the letter of credit that is not binding on the applicant unless the applicant consents to it in accordance with Section 5106(b). However, such an extension of time is primarily a matter between the issuer and the beneficiary, and should not be viewed as an amendment of the type subject to section 5106(b). The Pennsylvania Article 5 Committee views this Pennsylvania Comment to be a clarification of, rather than a change in, the 1995 Official Text and the Official Comments.

4. The first two sentences of the third paragraph of Official Comment 7 to Section 5-108 state, "Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor." These two sentences should be followed in accordance with their terms, and should not be viewed as being affected by the third sentence of Official Comment 8 to Section 5-108 ("A practice may be overridden by agreement or course of dealing."). In other words, a waiver of discrepancies in one or more
presentations cannot give rise to a "course of dealing" that would limit the effectiveness of the two quoted sentences of Official Comment 7. The Pennsylvania Article 5 Committee views this Pennsylvania Comment to be a clarification of, rather than a change in, the Official Comments.

Section 5110. Warranties.

_Pennsylvania Comment (2001)._ In Section 5110(a)(2), the phrase "any other agreement intended by them to be augmented by the letter of credit" should be construed broadly to include obligations of all types, including statutory obligations; it should not be viewed as limited to obligations arising from contract. The Pennsylvania Article 5 Committee views this Pennsylvania Comment to be a clarification of, rather than a change in, the 1995 Official Text.

Section 5111. Remedies.

_Pennsylvania Comment (2001)._ The 1995 Official Text of Section 5-111(e) states, "Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article." The Pennsylvania enactment of that provision, Section 5111(e), instead makes award of attorneys' fees and other expenses of litigation discretionary with the court, to be exercised when justice so requires. As a result, the first two sentences of Official Comment 6 to Section 5-111 ("The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses.") should be considered to be modified in Pennsylvania, to reflect the discretionary rather than mandatory nature of the award under the Pennsylvania enactment. However, the remainder of Official Comment 6 is unaffected by the nonuniform Pennsylvania enactment and remains applicable in Pennsylvania. In particular, without limiting the generality of the preceding sentence, the last sentence of Official Comment 6 ("Neither an issuer nor a confirmer should be treated as a 'losing' party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly, neither should be liable for fees and expenses in that case.") remains applicable in Pennsylvania.

Section 5115. Statute of limitations.

_Pennsylvania Comment (2001)._ The Pennsylvania enactment of Section 5115 makes a nonuniform change to the last sentence of the 1995 Official Text of Section 5-115, adding a reasonable period to permit discovery of a fraud or forgery.

Section 9101. Short title.

_Pennsylvania Comment (2001)._ The Pennsylvania Comments to the Pennsylvania enactment of the 1999 Official Text of Revised Article 9 (as supplemented by official amendments and errata through March 2000) were prepared by a subcommittee of the Business Law Section of the Pennsylvania Bar Association. The Pennsylvania Comments, like the Official Comments promulgated with the 1999 Official Text, are part of the legislative history of the Pennsylvania enactment under 1 Pa.C.S. § 1939 (relating to use of comments and reports). The Pennsylvania Comments supplement the Official Comments, and supersede the Official Comments to the extent of any inconsistency between them.
Section 9204. After-Acquired Property; Future Advances.

_Pennsylvania Comment (2001)._ As noted in Official Comment 5, subsection (c) abrogates the "relatedness rule" applied by some courts under former Article 9. Under the "relatedness rule," a future advance is deemed to be secured only to the extent that the future advances or other subsequently incurred obligation was considered by the court to be of the "same class" as earlier advances and obligations secured by the collateral. Several cases applying Pennsylvania's former Article 9 applied such a "relatedness rule." See, e.g., _In re Fassinger_, 246 B.R. 513 (Bankr. W.D. Pa. 2000); _Kitmitto v. First Pennsylvania Bank, N.A._, 518 F.Supp. 297 (E.D. Pa. 1981). Such holdings are abrogated by this section.

Section 9301. Law governing perfection and priority of security interests.

_Pennsylvania Comment (2001)._ The 1999 Official Text of this Section 9-301 contains an introductory preamble and is divided into paragraphs (i.e., divisions identified as “(1)”, “(2)”, etc.). In order to conform to preferred Pennsylvania legislative drafting style, the Pennsylvania enactment of this Section 9301 divides it into subsections (i.e., divisions identified as “(a)”, “(b)”, etc.), with appropriate subsection captions, moves the preamble into a new subsection (e), and reorganizes subsection (c) slightly. These changes are purely stylistic and no substantive difference from the 1999 Official Text is intended.

Section 9401. Alienability of debtor’s rights.

_Pennsylvania Comment (2001)._ In order to conform to preferred Pennsylvania legislative drafting style, the Pennsylvania enactment of this Section 9401 takes certain matter contained in subsection (a) of the 1999 Official Text of this section and moves it into a new subsection (c). This change is purely stylistic and no substantive difference from the 1999 Official Text is intended.

Section 9525. Fees.

_Pennsylvania Comment (2001)._ The Pennsylvania enactment of Section 9525 differs substantially from the 1999 Official Text of this section. Accordingly, substantially all of Official Comment 2 to this section, aside from the first sentence thereof, is inapplicable to the Pennsylvania enactment.

Section 9707. Amendment of pre-effective-date financing statement.

_Pennsylvania Comment (2001)._ Section 9707(e)(2) is nonuniform. In effect, it precludes the filing of a termination statement pursuant to Section 9707(e) with a Pennsylvania county prothonotary after the effective date of Revised Division 9 that relates to a pre-effective-date financing statement on file with that prothonotary. Section 9707(e)(2) was adopted to conform to a policy decision that is implemented by Pennsylvania’s nonuniform Section 9710: namely, that prothonotaries are not permitted to accept any further filings under Division 9 after the effective date of Revised Division 9. This policy decision is based on the judgment that it is preferable to take prothonotaries entirely out of the business of accepting filings under Division 9 after the effective date, rather than adopt a system whereby after the effective date prothonotaries would still be required to accept a limited class of filings (namely, termination statements). Accordingly, Official Comment 5 (and particularly the second paragraph of Example 4) should be read with this nonuniform limitation in mind.

The price of making this operational clean break is to render slightly more involved the process of terminating, after the effective date, a pre-effective-date financing statement on file with a
prothonotary. In many if not most situations, however, it will be unnecessary to effect such a termination even if the secured party wishes to terminate of record of its security interest. Specifically, in the very common situation in which a pre-effective-date financing statement was filed with a prothonotary for the purpose of complying with the so-called "dual filing" requirement imposed by Pennsylvania's former 9401(a)(3), in the event that the secured party wishes to terminate of record its security interest after the effective date, it will be sufficient for the secured party to terminate the central filing made with the Pennsylvania Secretary of State; the secured party need not also terminate the duplicative filing made with the prothonotary. That is because in such a situation, if the central filing has been terminated, a nonterminated filing with the prothonotary will be insufficient to continue perfected a security interest after the effective date of Revised Division 9. See Section 9705(c). (In this connection, observe that Revised Article 9 contains no analogue to the rule of Pennsylvania's former 9401(b) which gave effect to a financing statement filed in an incorrect filing office against any person who had knowledge of the contents of such financing statement.) By contrast, in the less common situation in which a pre-effective-date financing statement was filed with a prothonotary for the purpose of perfecting a security interest in farm-related collateral or consumer goods pursuant to Pennsylvania's former 9401(a)(1), in the event that the secured party wishes to terminate of record its security interest after the effective date, it will be necessary to terminate that financing statement (unless it has already ceased to be effective under Section 9705(c)).

If for any reason it is desired to terminate after the effective date a pre-effective-date financing statement on file with a prothonotary, that can be done pursuant to Section 9707(c). As illustrated in the first paragraph of Example 4 of Official Comment 5, this would require the filing of a new initial financing statement in a different filing office (which might be in another state) under Section 9706.

The nonuniform limitation in Pennsylvania’s enactment of Section 9707(e) applies only to pre-effective-date financing statements filed with a Pennsylvania county prothonotary. Hence Section 9707(e) does apply, subject to its conditions, to pre-effective-date financing statements filed with other Pennsylvania offices under former Division 9 (that is, the Secretary of the Commonwealth and the county recorders of deeds). It should also be noted that it may be possible to construe the uniform text of Revised 9-707(e) as being applicable only to offices that are "filing offices" as defined in Revised Article 9. Under that reading the uniform text of Revised 9-707(e) would not apply to prothonotaries in any event, and Pennsylvania's nonuniform limitation would be a clarification rather than a change.

Section 9710. Operations of prothonotaries’ offices after effective date.

*Pennsylvania Comment (2001).* Section 9710 is nonuniform. In accordance with Section 9501, after the effective date of Revised Division 9 Pennsylvania county prothonotaries will no longer be proper offices for filing financing statements. In light of this, a policy judgment has been made that Pennsylvania prothonotaries should not after the effective date accept any filings under Division 9, including termination statements relating to pre-effective-date financing statements on file with such prothonotaries. See Sections 9707(c)(2) and 9710(b) and the Pennsylvania Comment to Section 9710. However, pre-effective-date financing statements on file with a prothonotary may continue to be effective in certain circumstances until as late as June 30, 2006. See Section 9705(c). Accordingly, it is necessary for prothonotaries to retain their records and indices of pre-effective-date filings and respond to requests for information during that transition period (plus an additional period, to accommodate the possibility that litigation might arise after the transition period to which the effectiveness of a pre-effective-date filing during the transition period might be relevant). Section 9710 reflects that necessity.

[End of Annex I]
Pennsylvania Report on the 1995 Revisions to UCC Article 5
(Letters of Credit)

Preliminary Note: As noted earlier in this report, after the promulgation of the 1995 revisions to Article 5 of the UCC (“Revised Article 5”) by NCCUSL-ALI, the Business Law Section (formerly named the Section on Corporation, Banking and Business Law) of the Pennsylvania Bar Association appointed a subcommittee (the “Pennsylvania Article 5 Committee”) to study and report on the revisions and, if they deemed it appropriate, to draft legislation. The Pennsylvania Article 5 Committee therefore drafted S.B. 805, in consultation with the Legislative Reference Bureau, to enact Revised Article 5 as Pennsylvania law. S.B. 805 was introduced on April 13, 1999. The Pennsylvania Article 5 Committee prepared a report thereon (which included Pennsylvania Comments) dated March 12, 1998. The present Act was drafted to include Revised Article 5, substantially as set forth in S.B. 805, as well as Revised Article 9. The Committee, in consultation with the Pennsylvania Article 5 Committee, deemed it appropriate to produce a single report covering all aspects of the bill.

Accordingly, this Annex II sets forth the report of the Pennsylvania Article 5 Committee on Revised Article 5, as revised by the present Committee to reflect the combined enactment of Revised Article 5 and Revised Article 9 in the Act and certain other changes. The Pennsylvania Comments to Revised Article 5 prepared by the Pennsylvania Article 5 Committee, set forth in an appendix to its original report, have been incorporated into Annex I of this report. This report therefore supercedes the report of the Pennsylvania Article 5 Committee.

The members of the Pennsylvania Article 5 Committee were as follows

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KENNETH C. KETTERING
TIMOTHY A. KRIEGER
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RAYMOND P. PEPE
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INTRODUCTION

Letters of credit have been used for centuries to facilitate commerce, especially international trade. The use of letters of credit expanded dramatically after World War II, with the introduction of standby letters of credit. Each year, Pennsylvania financial institutions issue letters of credit with an aggregate face amount in the billions of dollars. Letters of credit are used by countless businesses, financial institutions and individuals in Pennsylvania, as applicants, beneficiaries or issuers.

Letters of credit are the subject of a specialized body of statutory and decisional law, as well as their own customs and practices. The statutory framework for letters of credit in Pennsylvania is Article 5 of the Uniform Commercial Code (the "UCC"). The Uniform Customs and Practice for Documentary Credits, published by the International Chamber of Commerce and most recently revised in 1993 as Publication No. 500 (the "UCP"), is widely regarded as a leading compilation of letter of credit practices. International and domestic letters of credit commonly contain provisions that make them subject to the UCP.

The original Official Text of Article 5 (the "Original Article 5") was adopted in Pennsylvania in 1953. While the Original Article 5 addressed many issues pertinent to letters of credit not theretofore addressed in any codification of letter of credit law, it did not deal with the full panoply of issues germane to letters of credit, and did not incorporate the UCP. Particularly as a result of the failure to incorporate the UCP, New York (among other states) adopted the Original Article 5 with a radically nonuniform provision that rendered Article 5 inapplicable to any letter of credit that, by its terms, was subject, in whole or in part, to the UCP. Given the large number of letters of credit issued in New York (which are typically subject to the UCP), the Original Article 5 never applied to a significant number of letters of credit, and cannot therefore be viewed as having succeeded in its goal of providing a uniform law applicable to all letters of credit.

After nearly forty years of operation under the Original Article 5, a revision was undertaken. The revision process began in 1990 with the appointment by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and The American Law Institute ("ALI") of a drafting committee (the "Drafting Committee"), whose work culminated in 1995 with the approval by NCCUSL and the ALI of a revised Official Text of Article 5 ("Revised Article 5"). The benefits of Revised Article 5 are well summarized in the "Balance of Benefits" section of the "Prefatory Note" to the Official Text. Among the most notable are its recognition of the role played by the UCP in letter of credit practice, and its flexibility in accommodating future changes in the UCP. Revised Article 5 has received rapid acceptance in other states, having been enacted in at least 44 states and the District of Columbia as of May 2000.

The Pennsylvania Article 5 Committee was constituted in 1996 by the Business Law Section (then named the Section on Corporation, Banking and Business Law) of the Pennsylvania Bar Association following advertisement in the Section's newsletter. Interested individuals were invited to request appointment, and all who requested were appointed. The Committee was composed of individuals from diverse geographic areas of the Commonwealth and included practitioners with experience in commercial law, generally, and letters of credit, in particular. The Pennsylvania Article 5 Committee began its review of the Official Text of Revised Article 5 in September of 1996, and met a total of fifteen times through March of 1998. During the course of the Pennsylvania Article 5 Committee's work, individual members corresponded with members of the Drafting Committee, and in September of 1997 the Pennsylvania Article 5 Committee held a conference with representatives of the Drafting Committee. After extensive study and discussion, the Pennsylvania Article 5 Committee concluded that the Revised Article 5 should be adopted in Pennsylvania with certain minor changes as set
forth under “Analysis” below, and with the addition of Pennsylvania comments to certain sections as set forth in Annex I to this report. The Pennsylvania Article 5 Committee now recommends adoption of Revised Article 5 with those changes and comments.

The Official Text of Revised Article 5 was drafted through an open and public process, involving representatives of all interested groups, and embodies compromises reached after long debate. Moreover, because letters of credit are routinely used in transactions that cross state and international borders, it is important that the laws that govern them be as uniform as possible from jurisdiction to jurisdiction. Accordingly, the Pennsylvania Article 5 Committee is deeply conscious that deviations from the Official Text are not to be undertaken lightly. The Pennsylvania Article 5 Committee nevertheless decided, after due consideration, to recommend substantive nonuniform changes on four points, namely:

- Revised §5108(e), concerning the allocation of responsibilities between judge and jury,
- Revised §5108(i)(5), relating to whether an issuer who honors a letter of credit draw comprising facially conforming documents which prove to contain a forged beneficiary’s signature, is discharged to the extent of such honor,
- Revised §5111(e), regarding mandatory attorneys’ fees, and
- Revised §5115, a discovery rule for the statute of limitations in cases of fraud or forgery.

These changes are discrete and relatively minor, and the reasons for them are described below. On the first and third of these points, which were the subject of vigorous debate at the national level, the Pennsylvania Article 5 Committee’s recommendations match the nonuniform changes adopted by New Jersey.

ANALYSIS

§5102. Definitions.

§5102(a)(1) - Definition of "Adviser".

The Original §5103(i)(e) definition of "advising bank" is replaced with a definition of "adviser". The new definition takes account of the fact that entities other than banks may and do advise letters of credit. The new definition also makes it clear that a letter of credit must be advised to a beneficiary, as opposed to some other party (see §5102(a)(3)), and that an adviser must have been requested to give the advice.

§5102(a)(2) - Definition of "Applicant".

The term "customer" is used in the Original §5103(g). The term "applicant" is in keeping with standard letter of credit terminology and fits with the clarification, likewise provided in §5102(a)(2), that an issuer may also be an applicant.

§5102(a)(3) - Definition of "Beneficiary".

The new definition makes no substantive change to Original §5102(1)(d), but the new definition makes it clear that the term "beneficiary" includes a person to whom the right to draw under a letter of credit has been transferred.
§5102(a)(4) - Definition of "Confiemer".

Revised §5102(a)(4) replaces the definition of "confirming bank" found in Original §5103(1)(f) with the definition of "confiemer". As with the definition of "adviser", the revised definition makes it clear, as it is in UCP Article 9, that a "confiemer" is a person whose undertaking is made at the request, or with the consent, of the issuer.

§5102(a)(5) - Definition of "Dishonor".

This definition is new.

§5102(a)(6) - Definition of "Document".

Original Article 5 distinguishes between a "documentary draft" (synonymous with a "documentary demand for payment"), on the one hand, and a "document," on the other hand. By contrast, in Revised Article 5, the term "document" includes both drafts and demands for payment. While a "document" under Original §5103 must be on paper, under Revised §5102(a)(6) a document may be presented "in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in [Revised] Section §5108(e), so long as the other medium is capable of being examined for compliance with the letter of credit."

The Pennsylvania comment to Revised §5102 makes it clear that, although the terms "written" and "writing," as used in Revised Article 5, may be read to include only paper and similar traditional media, the meaning of those terms is not so limited under other divisions of the UCC.

§5102(a)(7) - Definition of "Good Faith".

This definition of "good faith" is the same as that found Section 1201 of the UCC.

§5102(a)(8) - Definition of "Honor".

This definition is substantially similar to the definition of "honor" in Section 1201 of the UCC. As a result of Revised Section §5102(a)(10), a letter of credit may require the incurring of a deferred obligation or the delivery of items of value. This definition of "honor" expressly provides that "honor" of a letter of credit includes performance of such a deferred obligation or delivery of such items of value, as required under the terms of the letter of credit.

§5102(a)(9) - Definition of "Issuer".

As with Original §5103(a), Revised §5102(a)(9) does not restrict the issuance of letters of credit to financial institutions. Revised §5102(a)(9) excludes from the purview of Revised Article 5 individuals who make an engagement for personal, family or household purposes.

§5102(a)(10) - Definition of "Letter of Credit".

The first innovation of this definition is that a documentary presentation under a letter of credit can be for the payment of money or the delivery of an item of value, such as a commodity or a securities. The second innovation is to state explicitly that, as provided in Article 2 of the UCP, an issuer may issue letters of credit for its own account.
§5102(a)(11) - Definition of "Nominated Person".

Revised §5102(a)(11) introduces a definition of the term, "nominated persons," who are restricted to those persons the issuer has undertaken to reimburse for taking up documents or otherwise giving value under a letter of credit issued by the issuer.

§5102(a)(12) - Definition of "Presentation".

While new, this definition is consistent with the UCP.

§5102(a)(13) - Definition of "Presenter".

This definition is not substantively different from that in the Original §5112(c).

§5102(a)(14) - Definition of "Record".

This definition is new. By including non-paper media within the definition of "record", this definition accommodates existing and future technologies for storing data. The definition requires that, to qualify as a "record," the data must be retrievable in perceivable form.

§5102(a)(15) - Definition of "Successor of a Beneficiary".

This definition is new, and is used chiefly in Revised §5113, which delineates the rights and duties of the issuer with respect to a purported successor.

§5103. Scope.

Revised §5103 makes it clear that an instrument that is labeled a letter of credit but that does not function as such will not be treated as such under Revised Article 5. In addition, Revised §5103 gives the same legal status to all letters of credit, whether or not issued by a bank.

Revised §5103(c) states that, subject to certain enumerated exceptions, the parties may vary the effect of Revised Article 5 by agreement.

Revised §5103(d) codifies the "independence principle," one of the salient principles of letter of credit law.

The Pennsylvania Comment to Revised §5103 rejects those parts of the Official Comments to Revised §5103 and §5116 that state that a general provision in a reimbursement agreement, purporting to exculpate an issuer from liability unless it has acted in bad faith or committed gross negligence, is ineffective. See the Pennsylvania Comment to Revised §5103.

§5104. Formal Requirements.

Under Original §5104, a letter of credit must be "in writing and signed …." Revised §5104 takes account of the fact that a letter of credit may only exist in computer memory and may never be reduced to a "writing" or "signed". Thus, it requires only that a letter of credit, or any confirmation, advice, transfer, amendment or cancellation, be in a "form that is a record", and permits authentication not only by signature, but also "in accordance with the agreement of the parties or the standard practice referred to in
[Revised] Section §5108(e)." As discussed above, a "record," as defined in Revised §5102(a)(14) is "information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form."

§5105. Consideration. Revised §5105 is substantially the same as Original §5105.

§5106. Issuance, Amendment, Cancellation, and Duration.

Under Revised §5106(a), a letter of credit becomes enforceable when the issuer "sends or otherwise transmits" it either to the beneficiary or to the person requested to act as adviser. Original §5106(1) provides a dual, and potentially ambiguous, time for "establishing" a letter of credit: as to the customer, it is deemed "established" when sent to the beneficiary, and, as to the beneficiary, it is deemed "established" when received by the beneficiary.

Revised 5106(a) reverses the Original §5106(1) by providing that a letter of credit is revocable only if it expressly so provides. This change is in accord with Article 6.c. of the UCP.

Revised §5106(b) provides that an amendment or cancellation of a letter of credit is not binding on any person who has not consented to such amendment or cancellation unless the letter of credit is revocable or states that the issuer may amend or cancel it without the consent of such person.

Revised §5106(c) is new, and provides that, if there is no stated expiration date or other provision to determine the duration of a letter of credit, the letter of credit expires one year after its stated issuance date, and, if no issuance date is stated, one year after the date on which it is issued.

Revised §5106(d) is also new, and provides that, if a letter of credit states that it is "perpetual," it expires five years after its stated issuance date, and, if no issuance date is stated, five years after the date on which it is issued.

§5107. Confirmer, Nominated Person, and Adviser.

Revised §5107(a) is similar to original §5107(b), but expands the text to clarify the rights and obligations of the confirmer vis à vis the issuer.

Revised §5107(b) protects a nominated person who is not a confirmer by providing that such a nominated person is not obligated to honor or give value for a presentation.

Revised §5107(c) adds similar protection in favor of a person requested to advise who declines to act as an adviser. It also adds the requirement, similar to that in UCP Article 7.a., that an adviser check the apparent authenticity of the request to advise. See Revised §5107, Official Comment 2.

Revised §5107(d) specifies the rights and obligations of a person who performs the function of an adviser with respect to a transferee beneficiary of a letter of credit.

The rule in the Original §5107(d), which provides that the customer bears all risks of transmission and reasonable translation or interpretation of any message relating to a letter of credit as against the issuer, was deleted from the statutory text, but is preserved in UCP Article 16.
§5108. Issuer's Rights and Obligations.

Revised §5108(a) confirms that presentments under a letter of credit must strictly comply, not merely substantially comply, with the requirements of the letter of credit. A minority of courts had adopted the substantial compliance standard, with undesirable effect of diminishing the predictability of the treatment of letter of credit draws. Under Revised §5108(a), what constitutes strict compliance must be measured by the standard practices of financial institutions that regularly issue letters of credit.

Under Revised §5108(b), the issuer must either honor or give notice of discrepancies within a "reasonable time after presentation, but not beyond the end of the seventh business day after presentation". This is consistent with UCP Article 13.b., but is in contrast with the Original §5112, which gives the issuer up to the close of the third banking day following receipt of the documents.

Revised §5108(c) requires the issuer to give timely notice of discrepancies, failing which, the issuer is precluded from raising the discrepancies at a later date. This provision should result in greater certainty than the application of common law estoppel rules.

The Official Text of Revised §5-108(e) includes the following two sentences: "Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice." The New York enactment of that provisions deleted those two sentences. Those two sentences are likewise deleted from the Pennsylvania enactment. The deletion is partly in order to conform to New York law, which is desirable due to the preeminence of New York law as applied to letters of credit, and partly to avoid any question whether the Official Text might infringe upon the constitutional right to a jury trial.25

Revised §5108(f)(1) states a corollary of the independence principle (see §5103(d)), namely, that an issuer is not responsible for the performance or nonperformance of the contract, arrangement or transaction underlying a letter of credit.

Revised §5108(g) is new to Article 5 and reflects the requirement in UCP Article 13.c. that non-documentary conditions contained in a letter of credit be treated as though they do not exist.

Revised §5108(h) and the Original §5112(b) are substantially similar in that they both require an issuer who dishonors a presentation to return the documents or hold them at the disposal of, and to send notice to that effect to, the presenter.

Revised §5108(i)(1) provides that an issuer, who has properly honored a presentation, is entitled to be reimbursed by the applicant not later than the date of its payment of funds. As this provision is variable, parties may agree to different times or terms for reimbursement.

25 It should be noted that the Pennsylvania Article 5 Committee, in its report dated March 12, 1998, recommended a more limited change paralleling that made by New Jersey, which retained the second quoted sentence unchanged and revised the first quoted sentence to read: "Determination of the standard practice is a matter of interpretation for the court." This change was recommended to the New Jersey legislature by the New Jersey Law Revision Commission in its 1996 report on Revised Article 5. After the Pennsylvania Article 5 Committee disbanded, New York enacted Article 5, and (as noted in text) enacted Revised 5-108(e) with a nonuniform change slightly different than that adopted in New Jersey, though addressed to the same concerns. The Pennsylvania Article 9 Committee determined that it was preferable for Pennsylvania to follow the New York approach, given that the preeminence of New York law as applied to letters of credit.
The Official Text of Revised §5-108(i)(5) contains a new provision to the effect that an issuer who has honored a presentation under a letter of credit is discharged unless a signature of the beneficiary, required under the terms of the letter of credit, was forged. It is a fundamental part of letter of credit operations and law that the parties deal solely with documents, and not with performance, or any other aspect, of the transaction underlying the letter of credit (see, e.g., Revised §5108(g)). To require an issuer to verify a beneficiary's signature on presentation of documents is to obligate the issuer to engage in a factual inquiry at odds with the requirement that all conditions of a presentation be documentary. Nevertheless, under the Official Text of Revised §5-108(i)(5), if an issuer does not engage in this factual inquiry it faces potential double liability on the letter of credit: first to the beneficiary whose draw was honored because the documents facially complied with the requirements of the letter of credit notwithstanding that a signature was forged, and, second to the "true" beneficiary. Imposing on the issuer the additional burden of verifying required signatures would result in higher letter of credit transaction costs to cover the additional work required of the issuer, in issuers refusing to issue letters requiring draw documents containing signatures, or in issuers requiring applicants to hold the issuer harmless in the event the "true" beneficiary draws following a honor of a conforming draw containing a forgery. Moreover, even if an issuer were to adopt the practice of obtaining signature cards at the time of the issuance of the letter of credit, against which signatures could be matched at the time of a presentation, with the introduction of Revised §5113, if the beneficiary is a successor by operation of law, it would be entitled to have its draw honored even though its signature could not have appeared on the original signature card. In addition, under the choice of law provisions of Revised §5116, a Pennsylvania confirming bank that would have paid twice on a letter of credit under the Official Text of Section §5-108(i)(5) might not be entitled to seek reimbursement for more than one payment from an issuing bank located in another country (see Official Comment 2 to Section §5-116). Furthermore, uncertainty concerning how courts will construe the concept of forgery in the case of presentations made through electronic media may impede the evolution of electronic presentations in Pennsylvania. Finally, as among the applicant, the issuer and the beneficiary, it is the beneficiary who is the best situated to prevent forgeries of a beneficiary signature, and therefore to bear the risk of forgery of this type.

For all these reasons, the Pennsylvania Article 5 Committee rejected the new language in Revised §5108(i)(5) that would expose an issuer to double liability in the event that it honors a letter of credit draw comprising facially conforming documents which prove to contain a forgery of a required beneficiary’s signature. The Pennsylvania Article 5 Committee considered the possibility of adopting an approach such as that set forth in UCC §4A-203 (under which a bank that receives a payment order that has been verified by a commercially reasonable security procedure is presumptively entitled to rely on the payment order as having been validly authorized by its customer) or the preliminary text of proposed UCC Article 2B, which contemplates a similar rule for transactions within the scope of that Article. See Proposed §§ 2B-114 and 2B-115 (February 1998 draft). The Pennsylvania Article 5 Committee concluded, however, that, while it might have been preferable for the Official Text to have taken such an approach, it would not be desirable for Pennsylvania to adopt on its own the relatively elaborate provisions that would be necessary to implement it.

§5109. Fraud and Forgery.

To permit injunctive or similar relief to an applicant who claims that a letter of credit draw should be enjoined because of fraud, either in the underlying transaction or in the establishing or procurement of the documents tendered as part of the draw, would appear to be contrary to the independence principle. The independence principle would seem to require that a letter of credit and any draws thereunder be treated as entirely separate from the underlying transaction between the applicant and the beneficiary and any disputes between or defenses otherwise available to them. Nevertheless, Original §5114(b) made such
remedies available to applicants. Not surprisingly, this section of the Original Article 5 has been extensively litigated.

Rather than eliminating injunctive or similar relief as a remedy, Revised §5109 instead attempts more clearly and narrowly to circumscribe those situations in which such relief may be granted. While elimination of this provision arguably would have resulted in greater finality and predictability in letter of credit transactions, the Pennsylvania Article 5 Committee feels that it is preferable to retain this provision for the sake of uniformity among the states.

§5110. Warranties.

The warranties made or deemed to be made by a beneficiary under Original Article 5 have resulted in divergent judicial decisions. The first sentence of the Original §5111(a) provides that the beneficiary, on presentment, warrants that "the necessary conditions of the credit have been complied with." This has been viewed variously as a warranty of documentary conformity, or as a warranty that the presentation is in accordance with the terms of the underlying transaction. Revised §5110(a) provides that the beneficiary, on presentment, is deemed to make a warranty running to the issuer, the applicant and any other person to whom presentment is made, that there is an absence of forgery or material fraud in the presentment.

It can be argued that the inclusion of any beneficiary warranties intrudes on the independence principle. Nevertheless, a compelling argument can be made that wrongdoing of the type covered by the Revised §5110 warranties are not appropriately shielded by the independence principle. Furthermore, inasmuch as these warranties arise after honor, they do not impede the letter of credit payment process. The Pennsylvania Article 5 Committee seriously considered recommending expansion of the beneficiary warranties set forth in Revised §5110, and codification of the holding in Mellon Bank, N.A. v. General Electric Credit Corp., 724 F.Supp. 360 (W.D. Pa. 1989), by including a general post-honor warranty as to the veracity of the statements contained in draw documents. The rationale for such an expanded warranty is that, as between the applicant, the issuer or any other party giving value for a presentment on the one hand, and the beneficiary on the other, the beneficiary is in the unique position of being able to insure the veracity of its draw documents. If the applicant or the issuer is harmed by the breach of such a warranty, fairness would seem to militate in favor of allocating that risk to the beneficiary. As a practical matter, the applicant is likely still to have recourse against the beneficiary through the underlying transaction. If the issuer is not reimbursed for its honor by an applicant who has suffered an intervening insolvency, or is otherwise unable to pay, it can be argued that is patently unfair that the beneficiary would be permitted to keep the fruit of its dishonesty. Nevertheless, for the sake of uniformity, the Pennsylvania Article 5 Committee recommends that Revised §5110 be adopted.

§5111. Remedies.

Revised §5111 replaces the Original §5115. The scheme for fashioning remedies under the Original §5115 was based on UCC Article 2 and damages in connection with the sale of goods. This approach had the dual disadvantage of applying sale of goods theories in a domain in which there may be no transfer of goods underlying the letter of credit transaction, and grafting sales and contract laws concepts onto the very distinct body of letter of credit law.

Revised §5111 provides that the beneficiary of a letter of credit has no duty to mitigate damages, and permits specific performance if the letter of credit requires honor in the form of something other than the payment of money. Revised §5111 also supplies an applicant's remedy for wrongful honor, as well as for remedies against advisers, nominated persons and confirmers.
As under the Original §5115, Revised §5111 provides that incidental, but not consequential, exemplary or punitive, damages are available to Revised Article 5 claimants. This helps preserve the economic value of letters of credit.

The Official Text of Revised §5-111(e) states, “Reasonable attorneys’ fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.” The New Jersey Law Revision Commission, in its 1996 report to the New Jersey legislature, recommended that the term “must” be changed to “may,” so as to make the award of attorneys’ fees and other litigation expenses discretionary with the court rather than mandatory. The Pennsylvania Article 5 Committee agrees with that approach. This feature of the Official Text was the result of extensive debate at the national level. It was felt by some parties to the debate that the Official Text of Revised §5-111(b), which protects issuers from consequential damages, might encourage issuers to dishonor wrongfully; mandatory attorneys’ fees were viewed as a means of preserving an effective remedy for beneficiaries in the event of a wrongful dishonor. This is a legitimate concern, but the mandatory award of attorneys’ fees is by no means protective only of beneficiaries, and it is not even clear whether, systematically, it benefits beneficiaries more than it hurts them. For example, under the Official Text, a beneficiary whose issuer has wrongfully dishonored will be deterred from litigating the issue in a close case by the prospect that, if the beneficiary sues and loses, it will bear the issuer’s litigation expenses as well as its own (in addition to not receiving payment under the letter of credit). On the other hand, if a beneficiary is brave enough to bring a wrongful dishonor suit in a close case, it is plausible to suppose that the harshness of the foregoing result may tempt the court to apply the substantive law with a thumb on the beneficiary’s side of the scales; and since an important component of such wrongful dishonor suits, namely the determination of the standard practices of financial institutions, is to be determined by the judge rather than the jury (see Revised §5108(e)), it is conceivable that, over time, the result might be successive judicial opinions drifting further and further away from the “strict compliance” principle, to the detriment of issuers. Such possibilities are, of course, merely speculative. But it does seem that the “American rule” on litigation expenses is so deeply engrained in our legal culture that deviation from it is apt to have unpredictable long-term consequences. The Pennsylvania Article 5 Committee concluded that the case for this fundamental change has not been sufficiently made. With respect to the specific concern for beneficiaries which sparked the debate at the national level, the Pennsylvania Article 5 Committee believes that individual beneficiaries are adequately protected from truly wrongful dishonor by the provision allowing for award of attorneys’ fees on a discretionary basis; beneficiaries as a class are further protected by the fact that an issuer which repeatedly dishonors for no valid reason soon will find its letters of credit rejected in the marketplace.

§5112. Transfer of Letter of Credit.

Revised §5112 replaces the Original §5116(a). As under the Original §5116(1) and UCP Article 48.b., Revised §5112 provides that a beneficiary may not transfer its right to draw under a letter of credit unless the letter of credit expressly provides that it is transferable (except in the case of a transfer by operation of law, which is dealt with in Revised §5113). Revised §5112 allows an issuer to refuse to recognize any transfer that would violate applicable law, or that is not in compliance with the terms of the letter of credit or with other requirements of the issuer relating to transfer and within the standard practice referred to in Revised §5108(e) or which are otherwise reasonable.

§5113. Transfer by Operation of Law.

See the comments to Revised §5102(a)(15). Under Revised §5113(c), and consistent with the documentary nature of letters of credit, the issuer is not required to determine whether a purported
successor is in fact such a successor, and the Official Comment to this section states that the issuer may rely on documents (such as a certificate of merger) which on "their face indicate a person's status as a successor". In addition, Revised §5113(d) ensures the issuer's right to reimbursement in respect of a drawing by a purported successor even if such person is not in fact the beneficiary's successor.

Although requiring an issuer to honor a draw by a successor beneficiary may be viewed as conflicting with the independence principle, this section is consistent with the decisional law on the issue, and its enactment should prevent further judicial erosion of the independence principle in this area.

§5114. Assignment of Proceeds.

The Original §5116 covers both transfers of letters of credit and the assignment of proceeds of letters of credit. These are two distinct operations, and, as such, are logically treated under different provisions, as they are in the UCP (Article 48 and 49). This is the approach adopted under Revised Article 5, with assignment of proceeds dealt with in Revised §5114 and transfers of letters of credit dealt with in Revised §5112. As a result of these changes, the creation, perfection and priority of such a security interest are now governed by the law outside Article 5, principally Article 9 of the UCC.

§5115. Statute of Limitations.

Revised §5115 introduces a one year limitation period for claims under Article 5. The Pennsylvania enactment of this provision adds to Revised §5115 a discovery rule for cases of fraud or forgery.


Revised §5116(a) provides that the parties may, by agreement, select the applicable substantive law. Revised §5116(e) provides that the parties may select the forum for settling disputes arising out of an undertaking within Article 5. The jurisdiction and forum chosen need not bear any relation to the transaction. This approach is similar to that found in Section 4A507 of the UCC, relating to funds transfers, and reflects a departure from the conflict of laws principle that the transaction should bear a reasonable relation to the jurisdiction whose law is chosen to govern the transaction.

Absent an agreement by the parties as to governing law, Revised §5116(b) provides default rules for determining which jurisdiction's law will apply.

Similar to Article 2 of the UCP, Revised §5116 contains a provision that, for certain purposes, treats all branches of a bank as separate juridical entities.

Revised §5116(c) is entirely new. It codifies the parties' right to incorporate rules of custom or practice, such as the UCP, and provides that, in the event of is a conflict between the incorporated rules and Revised Article 5, the incorporated rules will prevail except as to the non-variable provisions specified in Revised §5103(c).

Revised §5116(d) is also new, and provides that Revised Article 5 will apply if there is a conflict between its provisions and those of UCC Article 3, 4, 4A, or 9.

§5117. Subrogation of Issuer, Applicant, and Nominated Person.

U.S. courts have generally held that, because an issuer satisfies its own primary obligation rather than the liability of another person by honoring a letter of credit draw, the common law remedy of subrogation is
not available to the issuer. Revised §5117 changes that result and effectively grants subrogation rights to the issuer "to the same extent as if the issuer were a secondary obligor."

**Miscellaneous**

The Original §5108 ("Notation Credit"; Exhaustion of Credit) has been omitted in Revised Article 5.

The Original §5113 (Indemnities) has been omitted as being adequately covered in other areas of the law.

The Original §5117 (Insolvency of Bank Holding Funds for Documentary Credit) has been omitted as being adequately covered by laws relating to bank insolvency.

[End of Annex II]
APPENDIX A

WHY STATES SHOULD ADOPT
UNIFORM COMMERCIAL CODE ARTICLE 9 - SECURED TRANSACTIONS

By the National Conference of Commissioners on Uniform State Laws*

Trillions of dollars of commercial and consumer credit are granted each year in secured transactions under Article 9 of the Uniform Commercial Code -- a manufacturer finances the acquisition of machinery and raw materials, a retailer finances inventory, a consumer finances furniture for a new house. The manufacturer, the retailer, and the consumer all depend upon Article 9 of the Uniform Commercial Code to make it possible for them to obtain the credit they need. Their creditors get assurance, in the form of the collateral that secures the granting of credit, that it will cushion the risk of default in the event the debtor does not pay the debt. Article 9 of the Uniform Commercial Code is absolutely necessary to economic function in the United States. It is the crankshaft for the American economic engine, and it is the envy of the rest of the world, which often struggles with the mechanics of credit granting and enforcement of creditor's rights.

Major revisions to Article 9 were completed in 1999. These revisions bring Article 9 into the 21st Century. There are many reasons that Revised Article 9 should be adopted in every state.

Technology. Paper-based transactions are giving way to electronic transactions. Revised Article 9 makes way for this revolution.

Volume. Article 9 was first proposed in 1951. Its last update was in 1972. Since 1972 the volume of commerce and the volume of credit has increased exponentially. Volume of secured transactions increases proportionately and directly with increase in economic activity in the United States. The filing system revisions are particularly necessary to meet the problem of increased volume.

New Collateral. New kinds of property and transactions have been developed since Article 9 was last amended. The scope of Article 9 expands to keep up and the 1999 revisions meet the needs for collateral into the new millennium. Examples of specific new collateral are deposit accounts and health insurance receivables.

Certainty of Perfection. Uncertainties about where to perfect a security interest under old Article 9 are overcome by the new basic rule in the 1999 revisions that makes the location of the debtor the place where the creditor will perfect the security interest.

New Liens. Statutory, non-possessory liens have proliferated since Article 9 was originally approved. Such liens represent a risk for creditors, and a potential conflict with security interests in collateral, if there is no public notice of their existence. Article 9 includes certain statutory, non-possessory liens for the purposes of providing public notice and setting priorities between creditors.

Clarification of Rules. Over time, provisions of Article 9 have been interpreted by courts, sometimes in conflicting ways. Some decisions deal with issues that were not expressly addressed in original Article 9. The result is ambiguity in the application of some rules. The revisions to Article 9 address and cure the accrued ambiguity problems.

* The executive office of the National Conference of Commissioners on Uniform State Laws has stated that this document is in the public domain.
**Consumer Impact.** Revised Article 9 addresses consumer issues that were not addressed in original Article 9.

**Commitment to Uniformity.** Amendments to Article 9 from state to state have created differences that impair interstate transactions. The revisions address specific kinds of secured transactions in oil and gas and agriculture in an effort to re-establish uniformity of law governing these kinds of transactions.

[End of Appendix A]
APPENDIX B

UNIFORM COMMERCIAL CODE, ARTICLE 9, SECURED TRANSACTIONS:
AN INTRODUCTION TO THE 1999 REVISIONS

By the National Conference of Commissioners on Uniform State Laws*

The Uniform Commercial Code has eleven substantive articles. Article 9, Secured Transactions may be the most important of the eleven. Article 9 provides the rules governing any transaction (other than a finance lease) that couples a debt with a creditor's interest in a debtor's personal property. If the debtor defaults, the creditor may repossess and sell the property (generally called collateral) to satisfy the debt. The creditor's interest is called a “security interest.” Article 9 also covers certain kinds of sales that look like a grant of a security interest.

The operation of Article 9 appears deceptively simple. There are two key concepts: “attachment” and “perfection.” These terms describe the two key events in the creation of a “security interest.” Attachment generally occurs when the security interest is effective between the creditor and the debtor, and that usually happens when their agreement provides that it takes place. Perfection occurs when the creditor establishes his or her “priority” in relation to other creditors of the debtor in the same collateral. Perfection occurs usually when a “financing statement” is filed in the appropriate public record. Generally, the first to file has the first priority, and so on.

Article 9 relies on the public record because it provides the means for creditors to determine if there is any security interest that precedes theirs—a notice function. A subsequent secured creditor cannot complain that his or her grant of credit was made in ignorance of the prior security interests that the record displays, and cannot complain of the priority of the prior interests as a result. Every secured creditor has a priority over any unsecured creditor.

The somewhat simple description in the prior paragraphs should not mislead anyone. Article 9 is not simple. There are substantial exceptions to the above-stated perfection rule, for example. Filing is not the only method for perfection. Much depends upon the kind of property that is collateral. Possession of collateral by the secured party is an alternative method of perfection for many kinds of collateral. For some kinds of property, control (a defined term) either perfects the interest or provides a better priority than filing does. There are kinds of transactions for which attachment is perfection. Priority is, also, not always a matter of perfecting a security interest first in time.

The following chapters of this backgrounder are meant to suggest and highlight Article 9 as revised in 1999. They are not a treatise on revised Article 9, but are meant to be a schematic guide to it. Each chapter addresses a specific topic qua issue. What follows in this introduction is an introduction to each of those issues.

1. The Scope Issue. The 1999 revision expands the “scope” of Article 9. What this means literally is that the kinds of property in which a security interest can be taken by a creditor under Article 9 increases over those available in Article 9 before revision. Also, certain kinds of transactions that did not come under Article 9 before, now come under Article 9.

2. Perfection. Although filing a financing statement remains the dominant way to perfect a security interest in most kinds of property, there are expanded property types in which “control” is the

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operative method of perfection. Specific perfection rules are extended to property that comes under the scope of Article 9 for the first time in the 1999 revisions.

3. *Choice of Law.* In interstate secured transactions, it is necessary to determine which state's laws apply to perfection, the effect of perfection and the priority of security interests. It is particularly important to know where to file a financing statement. The 1999 revisions to Article 9 change the rules substantially.

4. *The Filing System.* Improvements in the filing system in the 1999 revisions to Article 9 include a full commitment to centralized filing—one place in every state in which financing statements are filed, and a filing system that escorts filing from the world of filed documents to the world of electronic communications and records.

5. *Consumer Transactions.* Revised Article 9 makes a clearer distinction between transactions in which the debtor is a consumer than prior Article 9 did. Enforcement of a security interest that is included in a consumer transaction is handled differently in certain respects in the 1999 revisions to Article 9 than it was pre-1999. Although it governs more than consumer transactions, the good faith standard becomes the objective standard of commercial reasonableness in the 1999 revisions to Article 9.

6. *Default and Enforcement.* Article 9 provisions on default and enforcement deal generally with the procedures for obtaining property in which a creditor has a security interest and selling it to satisfy the debt, when the debtor is in default. Normally, the creditor has the right to repossess the property. Revised Article 9 includes new rules dealing with “secondary” obligors (guarantors), new special rules for some of the new kinds of property subject to security interests, new rules for the interests of subordinate creditors with security interests in the same property, and new rules for aspects of enforcement when the debtor is a consumer debtor.

**Scope of UCC Article 9**

What kinds of property may become collateral under Uniform Commercial Code, Article 9? This is the “scope” question. In the 1999 revision to Uniform Commercial Code, Article 9, scope expands. That is, more kinds of property may be used as collateral and more types of transactions are covered. Also, some kinds of property that may have fallen into a more general category of collateral under pre-1999 Article 9, become defined and subject to specific rules.

**Scope of UCC Article 9 Before the 1999 Revisions**

These kinds of property were (and will continue to be in the 1999 revisions to Article 9) subject to Article 9:

1. **Tangible personal property.** Property that is not real estate, but is tangible in form. Subdivisions of “tangible personal property” include “consumer goods,” “equipment,” “farm products,” and “inventory.”

2. **Fixtures.** This category of tangible personal property is separated from other personal property. Fixtures are items of tangible personal property that become so attached to real property that they are treated as part of the real estate. Fixtures begin as personal property, become real estate, but become personal property again when removed from the real estate. Special rules apply to fixtures under Article 9.
3. **Documents.** These are “documents of title” which, in general, establish that the person in possession has the rights to the goods which are represented in the title document. Bills of lading, dock warrants, dock receipts and warehouse receipts are included.

4. **Instruments.** An instrument generally is a negotiable instrument that evidences a right to the payment of money. An instrument becomes negotiable when it meets the criteria for negotiability in Article 3 of the Uniform Commercial Code. A note or draft is an example.

5. **General Intangibles.** Any intangible (meaning not goods) property interest that is not specifically addressed in Article 9. This is a gap-filling concept. Investment property is intangible property, for example, but because it is specifically addressed in Article 9, it is not a general intangible.

6. **Chattel Paper.** The writings that evidence a debt owed coupled with a security interest in goods or a lease of goods are chattel paper.

7. **Accounts.** An account is any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. A “deposit account” like a bank account is not included.

**Specific Exclusions From UCC Article 9 Before 1999**

These kinds of property or transactions are specifically excluded in the pre-1999 Article 9:

1. Statutory or common law liens.
2. Tort claims.
3. Deposit accounts (except those represented by certificates of deposit).
4. Governmental transfers.
5. Insurance claims or interests.
6. A right represented by a judgment.
7. Creation or transfer of an interest in or a lien on real estate.
8. Federally preempted rights.
9. Set off.
10. Transfer of a claim for wages, salary or compensation.
11. Sale of accounts and chattel paper as part of a sale of the business from which they arose.
12. Assignment of accounts and chattel paper for collection only, and
13. Transfer for performance of a contract or transfer of a single account to satisfy a pre-existing indebtedness.
Changes in the Scope of UCC Article 9 in 1999

The 1999 revision to Article 9 keeps many of the exclusions in pre-1999 Article 9 but makes some significant changes as well. This list of changes tend to fall (though not wholly) into two categories, interests that are no longer excluded and interests that were included under more general categories such as “general intangibles” or “accounts” but that need to be addressed with specific secured transaction rules:

1. **Nonpossessory, statutory agricultural liens.** These liens were excluded under Article 9 prior to 1999. They are included for purposes of perfection and priority in revised Article 9. Note other nonpossessory statutory liens remain excluded.

2. **Sales of payment intangibles and promissory notes.** Payment intangibles were a kind of general intangible, now distinguished by the characteristic of a primary monetary obligation. Promissory notes are a kind of instrument. These interests are sold, securitized and pooled. The interests sold are so like security interests that distinguishing these sales transactions from secured transactions is virtually impossible. The 1999 revision to Article 9 includes these kinds of property.

3. **Security interests created by governmental debtors.** The general pre-1999 exclusion has been narrowed. Only those governmental transfers that are subject to another statute on establishing and enforcing security interests are excluded. Federal preemption would, also, apply.

4. **Health insurance receivables.** The general exclusion of insurance proceeds in pre-1999 Article 9 is curbed for these specific kinds of receivables.

5. **Consignments.** Consignments of goods are included within the scope of Article 9 in the 1999 revisions. A consignment is a delivery of goods by the owner to another person, who sells for the consignor. A consignor is deemed to hold a purchase money security interest as against the consignee's secured creditors in the 1999 revisions to Article 9. Failure to comply with the requirements for a purchase money security interest potentially subjects the goods to the consignee's secured creditors. Before the 1999 revisions, a consignor had to perfect by filing a financing statement even though consignments fell within the scope of Article 2.

6. **Commercial tort claims.** The general exclusion of tort claims is narrowed so that security interests may be taken in commercial tort claims.

7. **Liens on property.** Certain liens on real property are included to the extent the lien establishes a right to payment.

8. **Deposit accounts.** Security interests may be taken in deposit accounts (with some restrictions). A security interest can be taken, therefore, in an ordinary bank account.

9. **Supporting obligations.** An example is a guarantee of payment or a letter of credit supporting an obligation to pay money.

Perfection of Security Interests
A security interest is perfected when the secured creditor has met the statutory requirements for notice to unsecured creditors, and most creditors who perfect their interests after the first secured creditor's perfection. There are four basic kinds of perfection: 1) perfection by filing; 2) perfection by possession; 3) perfection by control; and, 4) automatic perfection. All forms of perfection were available in Article 9 before 1999. However, Article 9 assigns a perfection method for each new kind of property within its scope in the 1999 revisions. “Control” as a method of perfection is expanded beyond the single kind of property, investment property, in which a security interest could be perfected by control in the pre-1999 Article 9. Thus “control” takes on new and larger significance after 1999 than it did before 1999.

Automatic perfection is specific to certain kinds of transactions. Purchase money security interests in consumer goods are a kind of security interest that perfects automatically. However, automatic perfection is usually temporary and extinguishes unless another appropriate form of perfection occurs during the temporary period of automatic perfection. There are more kinds of automatic perfection in the 1999 revisions than was the case before 1999.

Unless otherwise noted, conflicting security interests take priority in order of filing or other perfection in time. First in time usually wins, but note that purchase money security interests often provide a creditor priority notwithstanding the time perfection took place.

Each method of perfecting a security interest is discussed as follows:

1. **Filing a financing statement.** Filing a financing statement in the appropriate place of record maintained by a state will perfect almost every kind of security interest. (There are some exceptions.) The 1999 revisions make it clearer that filing will perfect, even if there is another method of perfection available. The old maxim, “When in doubt, file,” is even more appropriate after the 1999 revisions. This is the time-honored method of perfection.

2. **Possession.** A secured creditor may perfect a security interest in a broad range of collateral by taking possession of that collateral. Possession is the only way to perfect a security interest in money, except for proceeds from a sale of property subject to a security interest. The 1999 revisions to Article 9 clarify issues of possession as a method of perfection, but do not change the rules materially. For example, there is a method for a third-party bailee to acknowledge the creditor's interest. Such a method is not expressly provided pre-1999.

3. **Control.** Control as a method of perfection first applied to investment property in amendments to Article 9 that followed the 1994 revision of Uniform Commercial Code, Article 8. A creditor has control, and a perfected security interest, when the debtor's interest can be transferred by the secured creditor without the debtor's consent. For certain kinds of property, like certificated securities, possession is tantamount to control. The 1999 revisions of Article 9 allow a creditor to perfect a security interest in deposit accounts and letter-of-credit rights by control, as well as in investment property. Control is effectively the only way to perfect a security interest in deposit accounts and letter-of-credit rights. It is possible to perfect an interest in investment property by filing, but perfection by control always has priority over perfection by filing if there are conflicting security interests, no matter which kind of perfection occurs first in time.

4. **Automatic perfection.** In some kinds of secured transactions, attachment is perfection. The “purchase money security interest” (PMSI) in consumer goods is such a case of automatic perfection. It arises when credit is extended to purchase goods. Other types of security interests are automatically perfected but only temporarily. An example is a security interest in a certificated security perfected for 20
days even though there is no filing or possession when it is delivered for sale or the like. Generally, a purchase money security interest has priority over security interests perfected before it in time. There are new specific PMSI's in the 1999 revisions, such as a PMSI in computer software and livestock.

Examples of other kinds of security interests that perfect upon attachment are a sale of a payment intangible, a sale of a promissory note, a security interest in a healthcare insurance receivable (all new in 1999), and a broker's security interest in investment property created by the broker (from the 1994 Article 8 revisions). Most of these security interests will, also, have priority over other kinds of security interests that perfect earlier in time.

Choice of Law Rules

A transaction in which a creditor takes a “security interest” in the collateral of a debtor may involve more than one state. The creditor may be in one state, the debtor in another, and the collateral in another. Further, the collateral may move at some point in the transaction from one state to another. Both the creditor and the debtor may be able to claim more than one place as residence or domicile. Therefore, Article 9 has always had rules that determine which state's law will apply to the perfection, the effect of perfection and the priority of creditors in collateral.

When perfection requires filing a “financing statement” it is important to identify with certainty the state in which to file the financing statement. It is also important that creditors know with certainty that same state is the state in which they must search the record for financing statements indicating the existence of prior security interests. The state which the “choice of law” rules identify as the state whose law governs perfection, effect of perfection and the priority of creditors in the collateral, is the state in which the financing statement must be filed.

The 1999 revisions to Article 9 both simplify and substantially change the “choice of law” rules, meaning that in some cases different states will be the states in which perfection, the effect of perfection and the priority of creditors will be established than is the case under pre-1999 Article 9. The ultimate result is greater certainty for those who file financing statements and those who search for filed financing statements about which state is the right state.

Major Changes

There are two major changes in the “choice of law” rules:

1. Pre-1999, the basic rule chooses the law of the state in which the collateral is found to govern perfection and the effect of perfection of a security interest. If perfection occurs when a financing statement is filed, then the filing must take place in the state where the collateral is found. In the 1999 revisions, the basic rule chooses the law of the state in which the debtor is located as the law governing perfection, effect of perfection and the priority of a security interest in collateral. If a filing of a financing statement is required, then the statement must be filed where the debtor is, without regard for the location of the collateral. The location of the debtor is less likely to change than the location of the collateral and reliance on the location of the debtor provides creditors with more certainty about where to file and where to search. (Exceptions to both these rules to be discussed later on.)

2. If the debtor is a registered organization (corporation, limited partnership, limited liability partnership, limited liability company, etc.), pre-1999 treated the state with the chief executive office as the debtor's state. In the 1999 revisions, the debtor's state is the state in which it is a registered organization. Again, the objective of certainty about the place to file and the place to search is better
served by the new rule than by the old rule, but the change will probably result in very little change in the actual place of filing in the vast number of cases.

**Exceptions and Continuity**

There are prominent exceptions to the new general rule in the 1999 revisions to Article 9. In most instances these exceptions mean no practical change in the choice of law rules from pre-1999 Article 9:

1. All possessory (meaning that there is no filing of a financing statement) security interests are perfected under the law of the state in which the collateral is located (where the creditor has possession). The practical effect is to leave the law unchanged for possessory security interests in any kind of collateral.

2. For other kinds of collateral, there are also no effective changes in the “choice of law” rules. These other kinds of collateral include property subject to certificates of title, and minerals, letter of credit rights and investment property.

3. For deposit accounts, which were not in the scope of pre-1999 Article 9, the location of the bank determines the place for perfection, effect of perfection and non-perfection, and the priority of security interests.

4. For agricultural liens, which were not within the scope of pre-1999 Article 9, the location of the farm products determines the place for perfection, effect of perfection and non-perfection, and the priority of security interests.

5. There are security interests that perfect in the location of the debtor under pre-1999 Article 9. Since the location of the debtor is the fundamental rule in the 1999 revisions, perfection rules effectively do not change for these security interests under the 1999 revisions to Article 9. Included are security interests in accounts, general intangibles and mobile goods (no distinction between mobile and other goods in the 1999 revisions), automatic perfection of a broker in investment property, and automatic perfection of the security interest of a commodity broker in a commodity contract.

**Important Differences for Some Collateral**

Under the 1999 revisions, the law governing perfection may be different from the law governing effect of perfection and priority of security interests for some kinds of property. These kinds of property include negotiable documents, goods, instruments, money and tangible chattel paper. The effect of perfection and priority of nonpossessory security interests in these kinds of collateral will be determined by the location of the collateral. This means that the place to file or the place where automatic perfection takes place, is the location of the debtor, but the impact of filing may be determined under the law of the state where the collateral is.

**The Filing System**

The primary and principal method for perfecting a security interest under Uniform Commercial Code, Article 9 is to file a financing statement with the filing authority or authorities in the appropriate state. Before 1999, most states had centralized the filing of financing statements covering most collateral in one state office. A few states continued to have both general central and local filing for all collateral. Many of the states that have centralized filing for most collateral, still continue to have local filing for
some kinds of collateral. The result is a very mixed array of filing and search requirements. For filing
must facilitate the search of records by subsequent creditors who must be able to find prior security
interests. The fundamental objective of uniformity has been substantially impaired by the lack of
uniformity just in the filing systems.

The new filing system is designed to forge a uniform system that is simpler and
more reasonable to use:

1. **Medium neutral.** The new system is designed to be medium neutral. This simply means that
the filing systems are no longer to be required to file paper only. The systems can convert to any and all
forms of electronic communications for filing purposes.

2. **Centralized filing.** Every state will have a central filing authority. One place to file and one
place to search. The only exception is fixture filings, which must continue to be made (and searched) in
the real estate records.

3. **Simplified financing statement.** The statement must name debtor, creditor and generally
describe some collateral. No signature is required. Identity of filer is immaterial.

4. **Filing office operations.** No discretion resides in the filing office as to sufficiency of a filing.
A file cannot be cleared until one year after a termination occurs, extending the availability of the record
for one year longer than pre-1999 Article 9.

5. **Correction statement.** A debtor can file a correction to an improper or falsely filed financing
statement.

6. **Extended effective dates.** Most financing statements lapse after five years from the date of
filing. Two kinds of financing statements, those for public-finance transactions and for manufactured-
home transactions are initially effective for 30 years.

7. **National forms and fees.** There is an effort to establish the same forms for filing in every
state and to nationalize filing fees. Uniformity, therefore, is intended to go to the administration of filing
as well as to the basic law.

**Consumer Transactions**

In the 1999 revisions to Uniform Commercial Code, Article 9, there are special provisions for
secured transactions in which the debtor is a consumer. A “consumer transaction” is defined to be one in
which an individual incurs an obligation primarily for personal, family, or household purposes, a security
interest secures the obligation, and the collateral is held or acquired primarily for personal, family, or
household purposes. Most consumer secured transactions are consumer-goods transactions, meaning that
an individual purchases an item, i.e. a refrigerator, a couch, and finances the purchase. The item, i.e., the
refrigerator, the couch, are the collateral. If the consumer debtor defaults on the debt, the item is
repossessed. The 1999 revisions make a distinction between a consumer debtor and a consumer obligor.
In Article 9, a “debtor” is defined in terms of an interest in the collateral. An “obligor” is a person
obligated to pay the debt. Usually they are the same person, but there are obligors who are not debtors,
i.e., a person who guarantees the payment of the debt for the debtor. Most of the special consumer
transaction rules pertain to enforcement of a security interest after the debtor defaults on the basic
obligation. Some of these rules are as follows:
1. **Right to Redeem.** A consumer-goods transaction debtor may not waive the right to redeem collateral taken to satisfy the debt, a right which all debtors have. Redemption is the right under Article 9 that collateral be returned to the debtor if the debt is satisfied after a default. Commercial and business debtors are able to waive that right as part of credit acquisition. Consumer debtors will not be able to waive their right.

2. **Process Presumption.** In an action against a secured creditor for errors in enforcement and collection process, the presumption is that the collateral is worth the debt. In order to establish a deficiency, a creditor must rebut the presumption. These rules do not apply to consumer transactions. The courts will determine the rule to apply in consumer transactions and could choose a different rule.

3. **No Dual Status Rule.** The 1999 revisions to UCC Article 9 provide that the same collateral may secure a purchase-money security interest and a non-purchase-money security interest. This “dual status” rule is adopted in the 1999 revisions to Article 9, rejecting the opposing “transformation” rule applied in some pre-1999 court cases. Because the “dual status” rule may limit the benefit of purchase money security interests, consumer-goods transactions are excepted from its application. In a consumer-goods transaction, the courts must determine the appropriate rule to apply.

4. **Pre-Payment Rights.** Amendments to Article 2 of the Uniform Commercial Code that accompany the 1999 revisions to Article 9 provide greater protection for a consumer buyer of goods who pays in whole or in part before delivery of the goods. The buyer has an enforceable interest under Article 2 that allows the buyer to obtain the goods.

5. **FTC Rule 433.** A consumer's rights under Federal Trade Commission Rule 433 on preservation of claims and defenses are specifically recognized in the 1999 revisions to Article 9, and will continue even if the required notification in the appropriate record is missing.

6. **Deficiency Statement.** A consumer-goods debtor or consumer obligor is entitled to a written statement which provides the amount of a deficiency (what is owed after collateral is sold to satisfy the debt) and the calculation which results in that amount.

7. **No Partial Satisfaction.** A secured party may not accept collateral as partial satisfaction of a consumer obligation.

8. **Sufficient Description.** A description of consumer goods, a security entitlement, a security account, or a commodity account that is by category only is not a sufficient description when there is a consumer transaction. A security entitlement, a security account and a commodity account are types of investment property under Article 8 of the Uniform Commercial Code.

**Good Faith**

The 1999 revisions to Article 9 adopt the more “objective” good faith standard: “honesty in fact and observance of reasonable commercial standards of fair dealing.”

**Default and Enforcement**

When a debtor defaults on an obligation secured under Uniform Commercial Code, Article 9, a secured creditor has a right to take the collateral, sell that collateral, and apply the proceeds to pay off the debt. If the proceeds are insufficient to satisfy the debt, there may be a deficiency that the debtor will be obligated to pay. The creditor will be entitled to pursue the deficiency with the creditor's remedies.
available under other law. If there is a surplus after sale, that surplus will be the debtor's, unless other creditors act to obtain satisfaction of their debts, as well. Strict foreclosure is an alternative to sale. The creditor keeps the collateral in a strict foreclosure. The procedures under Article 9 are generally non-judicial procedures. (Although a creditor may seek enforcement in court.) Usually the secured creditor will repossess the collateral and pursue the available remedies without a court proceeding. Article 9 has its own procedural requirements for creditors. Not following them may mean that a creditor will not obtain a full remedy under Article 9.

The 1999 revisions do not fundamentally change the rules for enforcement of a security interest upon a debtor's default. The revisions provide for problems perceived in enforcement prior to 1999. Some of the important changes are as follows:

1. **Secondary Obligors.** A secured party owes duties to “secondary” obligors on the secured debt. A secondary obligor is liable for a debt only if the primary obligor does not satisfy the debt. A guarantor is an example. There are notifications that must be given to known secondary obligors by secured parties upon default. Contrary to the law of suretyship, the 1999 revisions generally prohibit waiver of rights by a secondary obligor. A secondary obligor can waive notification of disposition of the collateral, and (in a non-consumer transaction) the right to redeem, but only after the default has actually taken place.

2. **Deposit Accounts.** The enforcement rights of a depositary bank holding a security interest in a deposit account are expressly provided for. Security interests in deposit accounts under Article 9 were not possible before the 1999 revision.

3. **Warranties.** A secured party is subject to warranties of title, quiet possession and the like, applicable under other law (usually Uniform Commercial Code, Article 2), including rules for their exclusion or modification when disposing of collateral.

4. **Notification of Junior Creditors.** A secured party taking collateral and disposing of it upon default, has a broader obligation to notify other secured parties and lienholders who have filed financing statements against the debtor covering the same collateral than is the case under pre-1999 Article 9. There are specific notification requirements and a requirement for notification within a reasonable time (no less than 10 days after the earliest time of disposition of the collateral).

5. **Transfer to a Secondary Obligor from Secured Party.** A secondary obligor obtains the rights and assumes the duties of a secured party if it takes an assignment of the secured obligation, agrees to assume the secured party's obligations, or is subrogated to the rights of the secured party. This is not a disposition of the collateral by the secured party, but relieves the secured party of further duties and obligations.

6. **Transfer of Title to Secured Party.** The 1999 revisions make it clear that a transfer of record or legal title to a secured party in order to facilitate a disposition, is not of itself a disposition of the collateral.

7. **Strict Foreclosure.** A secured party may accept collateral in partial (except in consumer-goods transactions) or full satisfaction of a debt. Junior claimants rights are accounted for. Acceptance of collateral in satisfaction of a debt is not of itself an unreasonable delay of disposition. Strict foreclosure is permissible if it is commercially reasonable, and unreasonable delay can occur only if the foreclosure itself is not commercially reasonable.
8. **Damages for Secured Party's Noncompliance.** Secured parties are subject to a “rebuttable presumption” that the collateral value equals the debt if they do not comply with the enforcement procedures and requirements in Article 9 for non-consumer transactions. If there is breach on the part of the secured party, the obligor is credited with the difference between the actual disposition price and the price that would have been paid if the disposition had been conducted in a commercially reasonable manner. The “absolute bar” rule is not mentioned but should be unnecessary (except that it may be selected for consumer transactions).

9. **Deficiency Calculation.** If there is a procedurally regular disposition that nonetheless fetches a low price, and the disposition is to an insider transferee, the deficiency is calculated on the basis of what the price should have been in a commercially reasonable disposition.

[End of Appendix B]
APPENDIX C
WHY STATES SHOULD ADOPT REVISED UCC ARTICLE 5, LETTERS OF CREDIT

By the National Conference of Commissioners on Uniform State Laws*

The revision to Article 5 of the Uniform Commercial Code, Letters of Credit, updates the law governing the $200 billion U.S. letter of credit industry. Banks, and occasionally other persons, issue letters of credit to better assure payment to a third party by a customer up to a stated amount, for a stated period of time. Half of all exports outside the U.S. are financed by letters of credit.

Since the 1950s when this article was originally promulgated, the practices and technologies employed with letters of credit have changed substantially, including the use of electronic and computer technology. Litigation has increased as the volume of credits and the uncertainties of the law have stimulated controversies. Thus revision to UCC5 is both appropriate and timely.

There are a number of reasons why every state should adopt revised UCC Article 5:

**Letters Of Credit Are Important.** Letters of credit are very important in international trade. It has become a common method of guaranteeing and obtaining payment. The use of letters of credit has increased in recent years as foreign trade has expanded and increased. The law which regulates letters of credit UCC Article 5 is obviously an important component to expansion of foreign trade.

**UCC5 Recognizes The UCP 500.** UCC5 recognizes the Uniform Customs and Practices for Documentary Credits (UCP 500), which is used in most international letters of credit. The UCP 500 was promulgated by the International Chamber of Commerce and provides operational rules and standards that have international acceptance.

**Standards Of Practice Are Recognized.** Revised UCC5 specifically includes the most commonly used standards of practice. The revision coordinates with current standards of practice by including: deferred payment obligations, reasonable time to examine documents, preclusion, and the return of documents.

**UCC5 Is Modernized.** Original UCC5 in many ways is out of touch with current practice and major gaps cause unnecessary litigation. The revised UCC5 authorizes the use of electronic technology; expressly permits deferred payment letters of credit and two-party letters of credit; provides rules for unstated expiration dates and "perpetual" letters of credit; and conforms to existing practice for assignment of proceeds.

**Uniformity.** It is important that U.S. law regarding letters of credit be in accord with international rules and practices, but since letters of credit are a major instrument in domestic transactions as well, both international and domestic trade requires uniformity of law. These rules should be consistent within the United States.

**Conclusion.** The revised UCC Article 5 is a significant improvement over current provisions, and will lessen litigation, clarify matters which had been disputed, and encourage sound practices, promoting international trade. For all of these reasons, UCC5 should be adopted by all states as soon as possible.

[End of Appendix C]

* The executive office of the National Conference of Commissioners on Uniform State Laws has stated that this document is in the public domain.
APPENDIX D

UNIFORM COMMERCIAL CODE, REVISED ARTICLE 5, LETTERS OF CREDIT:
A SUMMARY

By the National Conference of Commissioners on Uniform State Laws*

A "letter of credit" is an instrument that participates in the payment system along with drafts, checks, electronic fund transfers, and money. But it expresses a unique creditor-debtor relationship that distinguishes it from the other methods of payment that are codified under the Uniform Commercial Code, and has distinct uses in the extension of credit not shared with other kinds of payment. It is specifically defined in Revised Article 5 as an undertaking by an "issuer" of the credit to a "beneficiary," the individual who gets paid, on behalf of an "applicant," the individual to whom credit is extended by the "issuer." As defined, payment requires the presentation of a document, usually a draft on behalf of the beneficiary to the issuer.

Commonly, the issuer is (but not necessarily) a bank or similar financial institution. Commonly, the applicant is a customer of that bank, and the beneficiary is somebody with whom the applicant is doing business and who wants assurance that he or she will be paid.

A typical example of a letter of credit involves an American company intending to buy goods from a European manufacturer. The European manufacturer is willing to do business providing that it has assurances of payment for the goods that are to be purchased. The American company applies to its bank, with which it has accounts and lines of credit, for a letter of credit. The bank issues a document that is in actual letter form. In that letter it guarantees to the manufacturer that it will pay money up to a certain amount, upon receipt of an appropriate document, usually a draft, on behalf of the manufacturer. The letter contains any other documentary conditions agreed upon.

The applicant then takes the letter to the manufacturer while negotiating the purchase of the goods. The letter provides guarantee of payment, facilitating the transaction. At the appropriate time in the transaction, the manufacturer is paid upon presentation of the draft to the bank. Then the bank debits the appropriate account of the American company or establishes whatever creditor-debtor relationship is contemplated between it and the American company. Ultimately the bank is paid.

It is possible that there will be other parties to the transaction recognized by law. There may be a "confirmer" on the letter. The confirmer may be another institution or individual obligated to pay on the letter when the appropriate document is presented by the beneficiary. In the example, to facilitate payment, the American bank engages a European bank as a confirmer so the foreign manufacturer will actually present the required draft for payment to the foreign bank. A confirmer is always liable on a letter of credit.

There may also be an "advisor" on a letter of credit. The advisor is a third party who facilitates the transaction by advising the beneficiary either directly or through another advisor that the letter of credit has been issued, confirmed, or amended. Institutions or individuals acting as advisors give beneficiaries an added assurance that a letter of credit is valid. In the example, the American bank can employ the services of another foreign bank to notify the foreign manufacturer that the letter of credit has been issued in the name of the manufacturer. An advisor does not have direct liability on the letter of credit.

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The letter of credit is of particular importance in international trade. With different payment systems in different countries, different laws governing fundamental transactions, business deals that must be transacted between strangers who are domiciled in different countries and who speak different languages, the letter of credit has become a common and accepted method of guaranteeing and obtaining payment. The foreign company has the comfort of the credit of the large, well-known financial institution when doing business with the domestic company.

The expansion of foreign trade is partly responsible for the large increase in the use of letters of credit in the United States. But there are other factors that have increased the use. Letters of credit generally are either ordinary commercial credits or standby letters of credit. The transaction used to illustrate typical use above involves an ordinary commercial credit. Standby letters of credit are used to back-up other primary creditor-debtor relationships, and in that sense are widely used in financing real estate development. What kind of large increase in use has occurred in the United States? In 1950 there were an estimated one-half billion dollars in outstanding credits. In 1989, the figure was $200 billion. Thus the need to revise Uniform Commercial Code Article 5 - Letters of Credit. That job is now complete.

The basic scheme of Article 5 does not change in the revision. The drafters' original intent was to provide a theoretical framework which would accommodate business practices however they would evolve. Original Article 5 defines the letter of credit and key terms, sets rules for establishing a letter of credit, provides some very basic rules prescribing the obligations of parties to a letter, including the obligations of confirmers and advisors, and establishes basic remedies for breach of these obligations. Revised Article 5 continues these objectives.

But Revised Article 5 leaves larger room for the evolution of business practices. Revised Article 5 does not change this basic orientation of the original drafters, except it considerably simplifies the rules.

For example, original Article 5 has rules for "notation credits" which are defined as credits that are payable only upon a notation of the amount of the payment on the actual letter. Honor of the draft or demand for payment requires the notation. This concept is not continued in Revised Article 5. It is one of those formal requirements with legal effect that results in dishonor of otherwise perfectly presented drafts or documents, impeding legitimate transactions.

Original Article 5 permits beneficiaries to use portions of a credit unless otherwise specified. Revised Article 5 simply leaves the issue to existing standards of practice. This is another example of simplification in the Revised Article 5.

The primary reason for such simplifications is the specific inclusion of standards of practice in Revised Article 5. It provides that "An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of that standard practice is a matter of interpretation for the court." The original Article 5 assumes that standards of practice are assumable as a matter of contract between the parties to a letter of credit. In Revised Article 5, the standards apply unless the contract otherwise specifies.

Standards of practice for letters of credit are very well formalized. First and foremost are the Uniform Customs and Practices for Documentary Credits (UCP), I.C.C. Publication No. 500, which are
promulgated by the International Chamber of Commerce. The UCP is updated on a decadal basis, and is much relied upon in international trade as a common language of letter of credit transactions. The simplification in revised Article 5 suggests a clear recognition of the UCP as the source for many of the formal requirements and details of letters of credit. This permits business practices to govern the evolution of letters of credit within the aforementioned basic framework that Article 5 intends to provide.

Since almost the entirety of Article 5 in revised or original form is variable by agreement, specific provisions of the UCP may also become part of the agreement between the parties, or its provisions may be waived by agreement as well.

Between the expanded reliance upon existing standards of business practices as a default rule in Revised Article 5 and the ordinary ability to vary the default rules in Revised Article 5, people and institutions are given maximum flexibility in the tailoring of their relationships under letters of credit.

The standard of practice provision in Revised Article 5 is undoubtedly the most significant part of these revisions. There are some other significant changes, however.

One of the stated purposes for these revisions is to update Article 5 for the age of electronic communications. (This is an important objective with almost all the revisions and amendments to the Uniform Commercial Code in the decades of the 1980s and 1990s.) Original Article 5's statute of fraud requirements -- calling for writings for enforcement -- are abolished. Under Revised Article 5, "A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (I) by a signature or (ii) in accordance with the agreement of the parties or the standard practice . . ."

The way to interpret this language is, simply, to say that a written document is no longer absolutely necessary to establish the existence of a valid letter of credit or of any other associated obligation. All that is required is an authenticated "record." A properly preserved computer record will suffice.

Another of the important changes concerns fraud and forgery in presentation for payment. As noted above, a letter of credit requires the presentation of a document, commonly a draft, for payment. What if the draft is fraudulent in some aspect or is forged? What is the issuer required to do? In certain instances under original Article 5, the issuer is required to honor such a draft, and in other cases may honor the draft. The issuer is not required under original Article 5 to police the process by which payment is obtained. However, in those situations in which the issuer has the discretion to honor the draft, the customer may petition the appropriate court to enjoin honoring the draft.

Original Article 5 uses the terminology of fraud in the transaction, and provides no guidelines with respect to which a court may consider the level of fraud that triggers the issuance of an injunction. In Revised Article 5, the terminology of fraud in the transaction is eliminated. A fraud that affects an injunction must be a "material" fraud. Further, Revised Article 5 establishes standards that the court must apply in determining whether to enjoin the issuer from honoring the draft. Included are factors of prohibition of injunction by other law, adverse effect upon the beneficiary, and availability of a remedy for fraud or forgery against the responsible individual or institution.
The remedies against an issuer for wrongful repudiation or dishonor of a letter of credit become more consistent under Revised Article 5 for letter of credit transactions. An issuer is bound to honor a proper documentary presentation. Repudiation occurs when the issuer communicates that a presentation will not be honored. A dishonor occurs when the issuer does not pay when the appropriate document is presented. Like any other legal obligation, the issuer is liable for wrongful repudiation or dishonor.

In original Article 5, the injured party can obtain the amount of the dishonored document plus incidental damages less the amount realized on the underlying transaction. If goods or documents of value as a result of the transaction are not sold to cover the losses, the issuer is entitled to them upon payment of judgment.

In Revised Article 5, the beneficiary or appropriate nominee is entitled to "the amount that is the subject of the dishonor or repudiation." If the obligation is not for payment of money, the injured party may have specific performance in lieu of damages, at the option of the injured person. Incidental damages are allowed, but not consequential damages. There is no obligation to cover the losses. If there is cover, the savings must be deducted from the recovered damages.

The applicant has a remedy for damages "resulting from breach," including incidental but not consequential damages. A breach by a confirmer or advisor gives rise to actual damages plus incidentals. Interest is due for any damages from the date of breach or dishonor. The prevailing party has a right to attorney's fees. There is a specific authority for prior agreement to liquidate damages. These provisions vastly improve and make more specific, the remedies available under Article 5.

A subject not specifically addressed in original Article 5 is the subject of subrogation of one party to another party to a letter of credit, upon payment of the other party's obligations. Subrogation rights are available by contract under original Article 5. The courts have not agreed upon their availability, otherwise, giving rise to confusion in the law.

Revised Article 5 provides specific rules. For example, if the issuer pays the beneficiary, the issuer is subrogated to the rights of the beneficiary and the applicant to the same extent as if the issuer were a secondary obligor of the underlying obligation. Subrogation rights do not arise until there has been an actual payment to the party whose rights are subrogated.

Subrogation puts the person with the subrogation right in the shoes of the person who benefited by the payment that triggers the subrogation right. Subrogation rights balance equities between parties in complex transactions like letters of credit. Revised Article 5 solves the judicial quandary under original Article 5 as to whether automatic rights of subrogation exist.

It is not possible to list entirely in a short summary all of the problems under original Article 5 that are solved in Revised Article 5. For example, it was not clear under original Article 5 whether a letter of credit had to be a documentary letter of credit. It is not entirely clear under original Article 5 that a letter of credit is different from a guarantee. Revised Article 5 erases these ambiguities.

Letters of credit are an important part of the credit granting and payment system, and the commercial law. Revised Article 5 should carry letters of credit into the 21st Century with the clarity and flexibility necessary for successful governance of letter of credit transactions. All states should act to adopt these important revisions as soon as possible.
[End of Appendix D]