



**TO:** Senate and House of Representatives Leadership, Connecticut General Assembly

**FROM:** Thomas J. Welsh, Esq., on behalf of The Connecticut Bar Association

**DATE:** May 7, 2001

**SUBJECT:** SB-1226 – Revised Article 9, Secured Transactions, of the Uniform Commercial Code: Problems from Delayed Enactment and New Non-Uniform Changes  
**PART 2 – Issues Created By Non-Uniform Judiciary Committee Changes**

## MEMORANDUM

Senate Bill 1229, a Bill adopting the 1998 Revisions to Article 9 of the Uniform Commercial Code, was reported-out of the Judiciary Committee of the Connecticut General Assembly on April 11, 2001. The Judiciary Committee text contained a number of non-uniform changes to the text in the Bill as originally proposed, as well as changes to the text recommended by the Advisory Committee panel established by the Connecticut Law Revision Commission<sup>1</sup>.

Revised Article 9 has now been adopted in thirty-five (35) states<sup>2</sup> and the District of Columbia, is pending in fifteen (15) other states<sup>3</sup>, including Connecticut, and is awaiting

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<sup>1</sup> The Connecticut Law Revision Advisory Committee on Revised Article 9 met from May, 2000 through January, 2001 and analyzed the complex provisions of Revised Article 9 in detail and to conform it to current Connecticut law. A number of the changes proposed by the Judiciary Committee had been considered and not recommended by the Advisory Committee.

<sup>2</sup> States that have adopted Revised Article 9 are Alaska, Arizona, Arkansas, California, Delaware, Georgia, Hawaii, Illinois, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia and Wyoming.

<sup>3</sup> States in which Revised Article 9 has been introduced and are pending are Alabama, Colorado, Connecticut, Florida, Louisiana, Massachusetts, Missouri, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, South Carolina and Wisconsin.

Memo to Senate and House of Representatives Leadership, Connecticut General Assembly  
Re: SB-1226 – Revised Article 9, Secured Transactions, of the Uniform Commercial Code:

**PART 2 – Issues Created By Non-Uniform Judiciary Committee Changes**

May 7, 2001

Page 2

Governors' signatures in several of these states. Most states will have enacted Revised Article 9 before the July 1, 2001 uniform date effective in virtually the entire United States.

The purpose of this two-part memorandum is to advise the General Assembly of the effect of the non-uniform changes adopted by the Judiciary Committee and issues that will arise if these changes are adopted.

A. **The Need for Substantial Uniformity:** Article 9 of the Uniform Commercial Code (generally referred to herein as “**Article 9**”) states the law regulating security interests in personal property and sales of accounts, contract rights and chattel paper. It states the methods of creating and perfecting security interests in tangible and intangible personal property and the priority rules governing conflicts with the rights of other parties, such as other lien creditors, in property subject to security interests. Article 9 has been enacted by all of the states in the United States and is enacted as part of the Uniform Commercial Code in Title 42a of the Connecticut General Statutes.

In this age of multi-state business entities and lending institutions and the movement of debtors and collateral across state lines, it is vital to maintain the commercial laws as uniform as possible across the United States, so to avoid impediments to secured credit everywhere, and particularly in Connecticut. For this reason, non-uniform changes in the Uniform Commercial Code should always be carefully considered in the light of the burdens of lack of uniformity. Increasing uncertainty and adding burdens will have the effect of driving up the cost of credit to buyers and businesses in Connecticut and of making Connecticut an unattractive state in which to do business.

As noted in a recent communication by Attorney Edwin Smith of Boston, a Commissioner of the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) and one of the members of the Revised Article 9 Drafting Committee

Even assuming that a particular change has a sound and well considered policy rationale, it is important not to stop there. There needs to be consideration of whether the benefits of the implementing that policy outweigh the burdens resulting from lack of uniformity. As we have stressed a number of times, lack of uniformity, among other things, drives up transaction costs and creates traps for the unwary.

B. **Consequences of Specific Proposed Non-Uniform Revisions:** Brief comments on the major proposed changes that such pose potential issues follow in the general order of importance:

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**PART 2 – Issues Created By Non-Uniform Judiciary Committee Changes**

May 7, 2001

Page 3

1. *No Information As To Collateral Descriptions* – Bill Section 94(C)(3) – Rev. §9-523(C)(3): The substitute language adds an exception to the requirement that the Secretary of the State provide information as to the "information provided in each financing statement" to except any requirement to provide information as to the *collateral*. This is a change in existing law that would remove authority for the Secretary of the State to provide collateral descriptions. A description of the collateral subject to a security interest is critical for any secured transaction and is part of the public record. Secured parties will not lend against collateral if they are unable to determine what collateral is set forth in any prior filings. Searchers should be permitted to view and to obtain copies of this information, as with any public record. We think that this issue is inadvertent, but it is essential that this authority be restored..

2. *Alteration Of "Proceeds" Definition* – Bill Section 2(a)(64) – Rev. §9-102(a)(64): The substitute language deleted subsection (B) of the definition of "proceeds". This would delete distributions from supporting obligations (such as guaranties and letter of credit rights) and distributions on account of claims (such as dividends and bankruptcy distributions) from proceeds. This limitation would have a serious effect upon the ability of a secured party to have a security interest in "supporting obligations" as defined under Revised Article 9 and is a major detrimental change to Revised Article 9 – such a change will restrict loans to Connecticut entities secured by "supporting obligations" and investment securities as collateral. This change is a major change from the standard definition adopted in all other states and will have the effect of diminishing the amount of secured credit available to Connecticut borrowers – since guaranty obligations and letter of credit rights supporting secured payment obligations, may no longer be relied upon. This could have a major adverse impact on commercial credit transactions in Connecticut. We are not aware of the policy issue addressed by this change and would be happy to address it specifically.

3. *Deleting Priority Over Later Lien Creditors* – Bill Section 37(a)(2)(B) – Rev. §9-317(A)(2)(B): The substitute language deletes §9-317(A)(2)(b) -- which made clear that security interests that have attached and been filed before the interest of later lien creditors have priority over the later lien creditors. This change would overturn the general principle in §9-317 that the priority of a secured party versus a lien creditor should not depend upon when or whether the first advance was made. Therefore, all lenders in all transactions governed by Connecticut law will have to require every borrower to take an advance when a loan is originally booked. This is a trap for out of state lenders and has not been adopted in other states. This change is not necessary, since the 45-day rule, cutting off non-committed future advances for intervening lien creditors, has been preserved in §9-323(b) of Revised Article 9 and this will have a major adverse impact on commercial credit transactions in Connecticut.

4. *Deletion of Filing To Protect Against Sale of Consumer Goods* – Bill Section 40(b) – Rev. §9-320(b): The substitute language allows the sale of consumer goods by

**PART 2 – Issues Created By Non-Uniform Judiciary Committee Changes**

May 7, 2001

Page 4

anyone (not just a merchant) free from a security interest *even if the security interest has been perfected by a prior filing*. This changes the current Connecticut law in CGS §42a-9-307(2), in effect for over 4 decades, as well as in Revised Article 9 and will render virtually ineffective any secured financing of consumer goods perfected by filing -- since the security interest can be defeated by any consumer buyer of the goods. We fear that this will bring most consumer secured financing to a halt in this state. Again, we are not aware of the policy reason for this change but would be happy to address it specifically.

5. *Non-Uniform Change to Risk of No Insurance – Bill Section 17(b)(2) – Rev. §9-207(b)(2)*: The risk of accidental loss or damage resulting from any deficiency in any debtor's insurance coverage, in the case of collateral in the possession of the secured party, was shifted from the debtor to the secured party in Connecticut. This is change in the law from current CGS §42a-9-207(2)(b), which has been the law in Connecticut for over 40 years. It is a non-uniform change that will be a surprise to all lenders. The response of lenders will likely be to obtain additional insurance (at additional cost to the debtor) in favor of the secured party.

6. *Excepting Payroll and Trust Accounts From “Deposit Accounts” Definition – Bill Section 2(a)(29) – Rev. §9-102(a)(29)*: The Judiciary Committee draft excepts payroll accounts, tax accounts and trust accounts from the definition of "deposit account" in Revised Article 9. The intention was apparently to protect employee payroll and associated accounts from being "swept" by a secured party after default. Since banks generally do not lend based upon these accounts, this will generally not be a problem – but it must be perfectly clear which accounts are ineligible for security interests. One way would be to require that the account must be *labeled* as a payroll, tax or trust account for the bank to know that a security interest is not permitted. This change would be best adopted as an additional sub-part (16) to section 9.D. of the Bill (section 9-109(d)) rather than to the section 9-102(a)(29) definition of “deposit accounts”.

For the above reasons, we respectfully request that the few problem changes noted above should be amended or not passed as part of this Bill.

Of course, if you have any questions, or if we can be of further assistance, please do not hesitate to call.