



McGUIREWOODS

Dedicated To Partnering With Our Clients

Banking & Financial Institutions Group Newsletter • August 2001 • Volume 1

OUR COMMITMENT TO OUR CLIENTS

Partnering

We are an essential part of our clients' success, working every day to enhance our clients' business relationships by making available our substantial contacts in the business community. We are partners in the broadest sense with our clients; ensuring their financial success is a core part of the service that we provide.

Efficiency and Practicality

We provide practical, results oriented advice, with a view towards bridging differences and closing transactions efficiently and economically.

Partner Responsibility

Partners are responsible for structuring transactions, negotiating and drafting all significant documents and closing all deals.

World Class Experience

The Financial Services Group has broad practice experience in all aspects of bank and institutional lending transactions, including cash flow and asset based lending, project and limited recourse financings, large and middle market cap financings, senior, subordinated and mezzanine financings, investment grade and leveraged transactions, domestic and cross-border deals and "work-out" and debtor-in-possession financings.

UCC Article 9 Revised for the Modern Age

BACKGROUND

The Drafting Committee of the Uniform Commercial Code has revised the Code's Article 9 ("RA9") for a modern age in which commerce has been largely freed of geographic constraints. RA9 addresses this new marketplace, where transactions take place on the Internet and many forms of commercial transactions not previously envisioned have become significant parts of our nation's commerce.

The committee's work was submitted to, and approved by, the American Law Institute and the National Conference of Commissioners on Uniform State Laws. It was then submitted to the 50 states and other jurisdictions. RA9 became effective on July 1, 2001, in 45 states and the District of Columbia. It will become effective on October 2001 in Connecticut; January 1, 2002 in Alabama, Florida and Mississippi; and fully effective in Colorado in 2003.

WELCOME CHANGES

RA9 is a welcome advance in the field of secured transactions law. It covers additional forms of collateral such as deposit accounts, healthcare receivables and electronic chattel. Just as importantly, it has streamlined the process of perfecting security interests by introducing a new state of organization filing rule for publicly registered debtors. This eliminates the need for countless local filings for nationwide transactions with respect to non-real estate collateral. RA9 also contains an innovative concept of authentication – with a debtor's agreement, the secured party may be permitted to file financing statements, whether initial filings or amendments, without the debtor's physical signature.

Further, RA9 clarifies one of existing UCC Article 9's more confusing set of provisions by setting forth detailed rules as to the priority of competing claims and liens with respect to the same collateral.

continued on page 2

U.S. OFFICES

Atlanta, Georgia • Baltimore, Maryland • Charlotte, North Carolina • Charlottesville, Virginia
Chicago, Illinois • Jacksonville, Florida • New York, New York • Norfolk, Virginia
Pittsburgh, Pennsylvania • Richmond, Virginia • Tysons Corner, Virginia • Washington, D.C.

INTERNATIONAL OFFICES

Almaty, Kazakhstan • Brussels, Belgium • Moscow, Russia (of counsel)

www.mcguirewoods.com

Preparing for and Adapting Secured Transactions for the UCC RA9

On July 1, 2001, Revised Article 9 (“RA9”) of the Uniform Commercial Code (“UCC”) became effective in each of the 45 states and the District of Columbia with a delayed effective date for the other states. Therefore, it is imperative that you review your institution’s portfolio of transactions which are secured by Uniform Commercial Code Article 9 collateral and which may also be secured by other collateral such as deposit accounts.

THE DOCUMENT REVIEW PROCESS

You should start by examining any security agreements entered into in connection with the transaction under review. If the type of collateral described in the agreement is already covered by both old Article 9 and RA9, and is not a type whose description has been materially changed under Article 9 (such as inventory or equipment), then you may not need to change the existing documentation.

Issues of continued perfection may still apply, however, as RA9 has new filing location rules (which are discussed separately in this newsletter).

DOCUMENTATION CHANGES

If the transaction under review, however, is secured by all of the debtor’s assets, including bank accounts (or collateral of a type whose RA9 definition is significantly different from Article 9, such as accounts and general intangibles), it may be necessary to amend the security agreement’s description of collateral to conform to RA9. Carefully review sections of the security agreement to ensure that the definitions relating to collateral meet the requirements of both the current Article 9 and the RA9. Language should also be added to provide for incorporation of any subsequent definitional changes to RA9.

Provisions such as representations and warranties used to gather information concerning location of collateral,

UCC Article 9 Revised continued from page 1

COMPLEX TRANSITION RULES

Unfortunately, there is a downside. In this case, it is a complex set of transition rules. These may require prompt action to continue the effectiveness of already perfected security interests. Action taken in good faith to perfect security interests under old Article 9 may no longer be sufficient. Unless you have also taken all the steps required by RA9, you might find that your perfected security interest lapsing long before you expect it to – though in many cases there is a one-year grace period.

Further, even if it isn’t physically changed, your collateral package could be redefined by RA9. If the collateral, which had been outside of the scope of old Article 9, is now covered by RA9, you may find yourself vulnerable to issues of competing law and security interests unless the

transition rules are followed carefully. In an accompanying article, we describe those things your institution should consider doing to avoid these pitfalls.

SUMMARY

All 50 states and the District of Columbia have adopted RA9, and with certain exceptions it has become effective by the July 1, 2001 deadline. In those states where there is a delayed effective date, a hodgepodge of legal issues could result. It will be important to determine exactly which law governs the description of collateral in a particular transaction, how and where one files against collateral and, if there is a dispute or proceeding, which jurisdiction’s laws will control, if one state has made effective RA9, and the other has not. ■

Banking & Financial Institutions Group Newsletter is a publication of McGuireWoods LLP.

©2001 McGuireWoods LLP. All rights reserved. Quotation with attribution is permitted. This publication offers general information and should not be taken or used as legal advice for specific situations which depend on the evaluation of precise factual circumstances.



control of collateral (such as information with respect to an institution where a deposit account may be located), location of debtor and exact legal name of debtor should also be updated.

In addition, the security agreement should be modified to take advantage of new features of RA9, such as providing for the debtor's authorization to file financing statements, continuation statements and amendments without the debtor's signature. Finally you should add provisions for control agreements applying to deposit accounts and letter of credit rights, as this is the only method of obtaining a perfected security interest in these assets under RA9. Consideration should also be given to adding provisions for control agreements in respect of other collateral, such as instruments (which security interests may also be perfected by filing), to provide for senior RA9 perfected security interests.

REVIEWING CURRENT TRANSACTION FILINGS

Current transaction filings should also be reviewed in light of the new RA9 requirements, taking a two-prong approach. First, determine whether the current description of collateral in the financing statement is still sufficient under RA9, as the new article has redefined collateral such as accounts and general intangibles. One important note, if a transaction is secured by all of a debtor's assets, a general phrase to this effect in a UCC-1 financing statement will still suffice for RA9 purposes despite any definitional changes applying to underlying collateral. Such a general description, however, will not under RA9 suffice for a collateral description in a security agreement. Secondly, determine whether you need additional filings to maintain already perfected security interests under the RA9 system. The most important element of this inquiry is the location of the debtor. Under RA9, the location for business organizations of public record, such as corporations or partnerships (the great majority of debtors in commercial transactions), is their state of organization, where one must file financing statements for non-possessory security interests. This is a change from old Article 9's focus on the debtor's primary place of business or where records of certain collateral are kept, so it is quite possible that old filings against a debtor may not satisfy RA9 requirements. Therefore, a careful review of current transactions, taking into account type of collateral and state of organization of debtor should be made to ensure

that such transactions do not become inadvertently unperfected after the end of the transition period for RA9.

FILING NEW FINANCING STATEMENTS

As soon as practicable, you should make filings in those jurisdictions where RA9 requires a new filing due to the changed determination of location of the debtor. RA9 provides a mechanism called a "financing statement in lieu of a continuation statement," which is in essence a new financing statement, which lists all currently effective financing statements on record, wherever filed against a debtor. This mechanism both extends the current perfected status of your transaction to the new RA9 filing jurisdictions and also maintains the priority of currently effective financing statements. Fortunately RA9 allows a financing statement to cover multiple debtors, and if the relevant security document so allows, to be filed without a debtor's signature.

COPING DURING THE TRANSITION

Unfortunately, not all jurisdictions that have adopted the current UCC will have implemented RA9 by the July 1, 2001 preferred effective date. As a result, you need to adopt procedures to cope until RA9 has become effective in all jurisdictions. First, with respect to all jurisdictions where debtors in current transactions are now deemed to be located, you should determine which jurisdictions have already adopted RA9. If one or more such jurisdictions have adopted RA9 then the "in lieu of" filings described above should be undertaken. However, for those jurisdictions which have not yet implemented RA9, you must follow the old rules until they do. As a result, for an extended period of time you may have to file both under the old Article 9 rules and RA9 at the same time in order to perfect security interests. If you don't, and the jurisdiction is still operating under old Article 9, enforcement could be blocked on the grounds that actions taken solely under RA9 are ineffective to perfect or continue your security interests. As a corollary, search strategies during the transition period (until at least July 1, 2006) will also have to be conducted under both old Article 9 rules and RA9 rules to ensure that one does not miss prior liens. ■

Methods of Perfection Under UCC RA9

Revised Article 9 (“RA9”) of the Uniform Commercial Code (“UCC”) went into effect simultaneously in 45 states and the District of Columbia on July 1, 2001. RA9 will become effective on October 1, 2001 in Connecticut; January 1, 2002, in Alabama, Florida and Mississippi; and fully effective in Colorado in 2003. RA9 contains a new scheme of location of filing places for perfection of security interests in non-possessory collateral, and new rules for collateral governed by RA9 but not covered by existing Article 9 of the UCC.

The chart below shows the methods of perfection with respect to various classes of collateral covered by Revised Article 9 of the Uniform Commercial Code.

Type of Collateral	Filing ¹	Possession ²	Control ³
Accounts	✓		
Cash		✓	
Tangible Chattel Paper	✓	✓	
Collateral in Possession of a Bailee			✓
Deposit Accounts			✓
Electronic Chattel Paper	✓		✓
Equipment	✓	✓	
Fixtures	✓		
General Intangibles	✓		
Goods	✓	✓	
Instruments	✓	✓	
Inventory	✓	✓	
Investment Property	✓	✓	✓
Letter of Credit Rights			✓
Negotiable Documents	✓	✓	

Note: Although several classes of collateral may have more than one method of perfection, perfection by possession or control of collateral creates a security interest prior in ranking to security interests perfected by filing.

1 Perfection by filing is accomplished by the filing of a UCC financing statement in the appropriate filing office of the appropriate jurisdiction. Most typically this would be the office of the secretary of state of the debtor's jurisdiction of organization.

2 Perfection by possession is accomplished by physically taking and holding the collateral. An example would be a Secured Party receiving and retaining in its possession a stock certificate.

3 Perfection by control is accomplished generally by the Debtor, the Secured Party and any necessary third-party (such as a commercial bank holding a deposit account or a bailee holding inventory) entering into a written control agreement satisfying the requirements of RA9. Note that with respect to deposit account and bailees, the mere giving of notice of a security interest by the Secured Party will not suffice to perfect a security interest in such collateral.

The general rules for the RA9 filing scheme are that:

- (i) the jurisdiction where possessory type collateral is located governs rules of perfection;
- (ii) the jurisdiction where the debtor is located governs perfection of all non-possessory collateral (other than deposit accounts and letter of credit rights which may only be perfected by obtaining "control"); and
- (iii) the jurisdiction where fixtures are located (due to their real estate-like qualities) will continue to be the jurisdiction of filing.

The debtor's location, in most cases, will be the jurisdiction of incorporation or organization.

In contrast, old UCC Article 9 focused on the location of collateral (possessory or tangible collateral) where the last act of perfection took place (such as mobile goods) or the location of a debtor's chief place of business and/or place where records of account were kept. ■

New MARAD Regulations Put Fishing Vessel Mortgages at Risk

THE CHALLENGE

New regulations from the Maritime Administration (MARAD) will create substantial risks for financial institutions that have extended credit to fishing vessel operators. Implemented under the American Fisheries Act (AFA), the regulations are effective October 1, 2001. Failure to comply with the new regulations could result in the loss of a lender's preferred vessel mortgage and expose a lender to significant liability risks.

WHAT'S AT STAKE

By creating stringent citizenship requirements, the MARAD regulations attempt to eliminate any foreign control over the American fishing industry. These requirements will affect both lenders and fishing vessel owners. MARAD can prevent a vessel owner from fishing in the United States exclusive economic zone if at least 75% of its shareholders are not United States citizens. Additionally, a non-citizen lender cannot hold a mortgage against a fishing vessel unless it complies with detailed requirements.

WHAT CONSTITUTES CITIZENSHIP?

In the context of a credit relationship, a state or federally chartered financial institution with at least 51% of its



shares owned and controlled by United States citizens is defined as a citizen. The threshold is higher if a lender is not a state or federally chartered financial institution. To establish citizenship by "fair inference," a MARAD Lender must submit evidence that 65% of its stockholders have United States addresses. The MARAD Lender must use the address of the beneficial owners of its shares to determine if citizenship requirements have been met, so financial institutions will need to obtain ownership information from brokers, trusts and mutual funds to satisfy the regulations. Each entity that owns stock in a financial institution must also have at least 51% of its shares or interest owned and controlled by U.S. citizens. Consequently, the MARAD regulations make it difficult, if not impossible, for a publicly traded financial institution to satisfy the citizenship requirements.

continued on page 6

MARAD Regulations *continued from page 5*

If a financial institution cannot qualify, then MARAD will have to review and approve its loan documents to determine that it is not exercising impermissible control over a fishing vessel. The preferred vessel mortgage must also designate a qualified mortgage trustee who satisfies numerous technical requirements. To date only one entity has sought approval from MARAD to serve as a mortgage trustee. The lack of interest by the private sector may force non-citizen lenders to create entities that qualify as trustee mortgagees under the MARAD regulations.

The approval of loan documents by MARAD also creates new challenges. In the past, MARAD hasn't reviewed loan documents under the AFA, so it is uncertain whether they will require significant changes in the structure and documentation of existing credit facilities. A lender, therefore, must be actively involved in the MARAD review to preserve the integrity of an existing transaction. If the loan documents do not satisfy MARAD, then a fishing vessel could lose its fishing endorsement. The potential loss of a fishing endorsement creates significant lender liability concerns. n



Banking & Finance Contacts

NEW YORK, NEW YORK

9 West 57th Street, Suite 1620
New York, NY 10019-2602

CHARLOTTE, NORTH CAROLINA

John C. Fennebresque, 704.373.8989
Bank of America Corporate Center
100 North Tryon Street, Suite 2900
Charlotte, NC 28202-4011

CHICAGO, ILLINOIS

Debra S. Clark, 312.641.2725
77 West Wacker Drive, Suite 4500
Chicago, IL 60601-1635

RICHMOND, VIRGINIA

Nancy R. Little, 804.775.1010
One James Center, 901 East Cary Street
Richmond, VA 23219-4030

BALTIMORE, MARYLAND

James P. O'Hare, 410.659.4418
7 Saint Paul Street, Suite 1000
Baltimore, MD 21202-1671

ATLANTA, GEORGIA

Howard W. Walker, 404.443.5731
1170 Peachtree Street, N.E., Suite 2100
Atlanta, GA 30309



Banking and Financial Institutions Group

9 West 57th Street
Suite 1620
New York, NY 10019-2602

