

COHEN, SALK & HUVARD, P.C.
ATTORNEYS AT LAW

BENNETT L. COHEN
BRUCE ALAN SALK
BRUCE K. HUVARD
BRUCE J. WALDMAN
BARRY I. MORTGE
CHRISTYL L. MARSH
FREYA L. FUNG

630 DUNDEE ROAD, SUITE 120
NORTHBROOK, ILLINOIS 60062

TEL 847.480.7800
FAX 847.480.7882
E-MAIL BCOHEN@CSHLEGAL.COM

WRITER'S DIRECT DIAL 847.480.7989

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SECURED LENDING ALERT

Reviewing UCC Termination Statements – A Trap For The Unwary

Reviewing UCC terminations in a UCC search is often viewed by some secured lenders as a mundane administrative task. Quite to the contrary, UCC terminations are an essential and important component of a secured transaction, and careful review and evaluation of filed UCC terminations of record in a UCC search are essential for a secured party's protection.

Let's first examine the basics of a UCC termination, and then delve deeper into the subject.

1. Upon enactment of Revised Article 9 of the Uniform Commercial Code (the "Code") in 2001, a UCC termination was no longer required to be signed by the secured party of record terminating its filing. The UCC termination, as well as amendments, assignments, partial releases, and continuations of a UCC financing statement, are all accomplished by filing a UCC amendment form and checking and/or completing the appropriate sections of the amendment form (i.e., filling out the appropriate sections for a termination, amendment, assignment, partial release or continuation).

2. The following basic information is required to be inserted in the UCC amendment in order to file an effective UCC termination:

a. The initial UCC financing statement number being terminated needs to be inserted in Box 1a. The date such initial UCC was filed should also be entered in Box

1a (although it is technically only required in those states where the filing number for the initial UCC filing is also the same filing number used by such states for subsequent amendments to the same filing).

Note that when you terminate a UCC filing, you only list its initial UCC filing number in Box 1a. You do not list in the UCC termination, the separate filing numbers for all subsequent amendments to the UCC filing being terminated (such as the filing numbers for continuations or amendments for name, address or collateral changes, etc.).

b. Box 2 needs to be checked to reflect that the amendment is being used to terminate the initial UCC described in Box 1a.

c. In Box 9a, the name and address of the secured party authorizing the termination of the UCC is inserted*. On rare occasions, Box 9a is used to reflect that the termination has been authorized by the debtor (see discussion below).

A crucial principle to remember is that an "unauthorized" filed termination is not effective to terminate the UCC filing described in such termination. If you rely on a UCC termination in a search that was not authorized to be filed by the "secured party of record" (as described below) or by the debtor (but only under the special circumstances described below permitting a debtor to terminate a UCC filing), you act at your own peril, because the UCC filing that you thought was properly terminated, is still effective, notwithstanding the filed termination of record.

(*technically, Box 9a does not need to be completed for an effective termination, however, it's always a good idea to complete Box 9a)

3. A general principle to keep in mind is that only the "secured party of record" as described in Code Section 9-511 has authority to terminate a UCC filing (except for the limited circumstances described below where a debtor is authorized to terminate a UCC filing).

a. If a UCC filing was previously assigned by Lender A to Lender B, upon the filing of such assignment, Lender B becomes the "secured party of record" (replacing Lender A), and the only party authorized to terminate the UCC filing, provided, however, that Lender A in fact made a full (total) assignment of its interest in all of the collateral described in the initial financial statement to Lender B.

This last paragraph highlights a significant ambiguity under the Code when dealing with UCC assignments (and the following discussion necessarily focuses only on UCC assignment issues as they pertain to UCC terminations).

Many lenders who review UCC assignments from one secured party (an "assignor") to another secured party (an "assignee"), just assume that the UCC assignment reflects a full assignment of the UCC filing from the assignor to the assignee, as opposed to a partial assignment of the UCC filing from the assignor to the assignee.

Many lenders would be surprised to learn that UCC assignments need to be individually examined to evaluate whether the UCC assignment was in fact a full assignment or a partial assignment. Many UCC assignments are silent on their face about whether the UCC assignment in question is a full assignment or a partial assignment. In such case, a third party searcher in question who wants to make sure that all secured parties of record terminate an initial filing that has previously been assigned, will need to contact all secured parties of record in the chain of the UCC filing to confirm whether or not a full assignment was made. If a full assignment was not made from the first secured party to the second secured party, there are multiple secured parties of record, and they both need to authorize a termination of the initial financing statement.

b. I am informed by Paul Hodnefield, Assistant General Counsel for Corporation Service Company, that many filing offices leave the assignor as a secured party of record, after the filing of an assignment. This is a result of the filing offices' limited discretion under Revised Article 9. As discussed below, the determination of whether an amendment reflects a full or partial assignment is entirely the searcher's responsibility.

c. It should also be noted that under Code Section 9-514(a), the assignee may be named in the initial UCC filing itself (and thus no amendment is used), and in such case, such assignee is the "secured party of record" with respect to such UCC filing, and there is no ambiguity as to whether there is more than one secured party of record.

d. Another Code section dealing with UCC assignments is found in Code Section 9-514(b), which allows a secured party of record to assign all or part of its power to authorize an amendment to a financing statement. Similar to my comment in subsection (a) above, searchers would be put on inquiry notice upon reviewing such an assignment, as to exactly what security interest or powers were assigned.

If you want to be 100% sure that a UCC filing that has previously been assigned is properly terminated, you will need to exercise due diligence and inquire of the parties as to exactly what was assigned. It may further be necessary to have all secured parties in the chain of that UCC filing terminate or authorize the termination of such initial filing.

e. There may be more than one secured party of record on a UCC filing. Multiple secured parties can be reflected in the initial UCC financing statement or one or more secured parties can be added in one or more subsequent amendments to the initial UCC financing statement, resulting in multiple secured parties of record. In such case, all secured parties of record must terminate the UCC filing.

f. Code Section 9-512(e)(2) contemplates that one or more secured parties may be deleted from a UCC filing by amendment, with the proviso that an amendment purporting to delete all secured parties of record is ineffective.

g. If Bank A and Bank B merge with the surviving bank being Bank B, Bank B becomes the successor to the "secured party of record" with authority to terminate UCC filings previously filed in favor of Bank A. Official Comment 8 to Code Section 9-509.

4. Let's examine some possible scenarios in which a filed UCC termination in a UCC search is not authorized (and consequently, not effective to terminate the UCC filing described therein):

a. Many of the "unauthorized" terminations today are based on an incorrect initial UCC financing statement number inserted in Box 1a of the UCC termination. These errors can result from typographical errors in preparing the termination or from reliance on either hard to read copies of the initial UCCs being terminated or reliance on incorrect UCC numbers reflected in a search report or other listing. Some lenders would be shocked to learn that thousands of these erroneous terminations are being filed monthly around the country.

b. Another lender has improperly terminated the UCC statement. In some prospective refinancings, the new lender may improperly terminate the existing lender's UCC filings on the assumption that the new loan(s) were going to be consummated, and subsequently the new loan or loans fall through. Obviously, it's important that an existing lender never authorize a new lender to terminate the existing lender's UCC financing statement until the existing lender has received the required payoff amount in good funds (and any other conditions, if any, set forth in the new lender's payoff letter are satisfied).

It should also be remembered that a security interest in collateral evidenced by a UCC financing statement may not only secure a loan being paid off, but it may also secure other loans or obligations owed by the debtor or a third party, so that a clear written commitment issued to the new lender by the existing lender being paid off to terminate all of the existing lender's UCC financing statements against a particular debtor upon payment in full of the specified debt is essential and should be included in the payoff letter.

c. Another trap for the unwary lender is when there is more than one secured party of record listed on a UCC financing statement, as described above. Code Section 9-510(b) provides clearly that "[a] record authorized by one secured party of record does not affect the financing statement with regard to another secured party of record." Thus, there have been instances where less than all of the secured parties of record have terminated the UCC financing statements, resulting in an effective filing remaining of record with respect to those secured parties who did not terminate. See Official Comment 3 to Code Section 9-510.

d. The debtor has improperly terminated the UCC statement. There have been unscrupulous debtors who have improperly terminated UCC statements filed against them even though the secured debt remained unpaid.

5. If a debtor has in fact paid off its debt in full to a secured party, and the secured party delays in providing terminations, a debtor is authorized to terminate the secured party's filing under the following Code sections (which are different for consumer collateral and commercial collateral):

Consumer Goods - Under Code Section 9-513, secured parties must terminate a UCC filing covering consumer goods once the secured obligation is paid and there is no further commitment to extend credit. Such terminations must be filed by the secured party within the earlier of (a) one month after the secured obligation is paid and there is no further commitment to extend credit, or (b) twenty (20) days after the secured party receives an authenticated demand for the termination from the debtor.

Non-Consumer Goods - Under Code Section 9-513, a secured party generally must terminate a UCC filing covering non-consumer (i.e., commercial) collateral within twenty (20) days after a secured party receives an authenticated demand from the debtor, and the secured party must, within said time period, send the debtor the termination or file the termination in the appropriate filing office. Such obligation to terminate is conditioned upon the secured obligation being paid and there being no further obligation to make an advance, incur an obligation or otherwise give value.

Debtor's Ability To File Terminations. If the secured party does not comply with such termination requirements listed above for consumer or non-consumer goods, Code Section 9-509(d)(2) provides that the debtor may file the termination statement. This is the instance described earlier in which the debtor is "authorized" by statute to file the termination itself.

It should also be noted that a secured party can be liable for actual and statutory damages under Code Section 9-625 for failure to timely provide to the debtor (or file) the termination statement.

6. If a UCC search reflects that a debtor has terminated its own filing, such fact raises an immediate red flag that the secured party shown on the terminated filing must be contacted to confirm that no further debt is outstanding (and that there is no commitment to extend debt or other credit to the debtor). It is also recommended that such secured party confirm in writing to the new secured party that it no longer has any debt outstanding and that its security interest has been terminated. Since it would be difficult for a new secured party to confirm the debtor's strict compliance with Code Section 9-513 above, it is also desirable that the prior secured party authorize the new secured party in writing to terminate its UCC filing(s). A second termination would be desirable in this instance as the termination filed by the debtor may turn out to be ineffective. Whether or not the new secured party has the ability to obtain such authorization from the prior secured party is another issue.

7. Under former Article 9, terminated UCC statements were removed from the search records. However, under Code Section 9-519, the filing officer in each jurisdiction is required to maintain in the search records each UCC filing which has been

terminated for at least one (1) year after the date such UCC filing would have lapsed had it not been terminated. This is a significant benefit for secured parties as it give them the opportunity to review UCC filings and their terminations and conduct due diligence to determine whether the UCC terminations were authorized.

The Official Comment to Code Section 9-519(g) explains that this one year rule "... increases the amount of information available to those who search the public records. The rule also contemplates that searchers - not the filing office - will determine the significance and effectiveness of filed records."

There is a human limitation on this one-year safeguard built into the Code. Even though Code Section 9-519(g) requires that the filing office not remove a financing statement for one year after it would have lapsed (even if it was terminated), it has been disclosed that some search services (and perhaps filing offices) have provided less than comprehensive searches, by failing to reflect in the search terminated filings required to be kept in the record for the required period (i.e., one year after its scheduled lapse date). The inadequacies of such searches eliminate the protection built into the Code by Section 9-519(g) and constrain the searcher's ability to conduct due diligence.

8. Some secured parties actually instruct a search company to exclude terminated financing statements from the search results, based on the mistaken belief that terminated UCC statements can no longer be effective. This practice is very risky as there are many "unauthorized" terminations being filed throughout the country, as discussed above, and excluding terminations from a UCC search prevents a secured party from reviewing and evaluating each termination.

9. Let's examine some practice tips to avoid the risk of being stung by an "unauthorized UCC termination":

a. A secured party should always obtain a full UCC search (which search should include all UCC filings of record as well as all terminations still of record).

b. Every UCC termination in a UCC search needs to be carefully scrutinized to make certain it was an "authorized" termination. Prior secured parties who have terminated UCC statements should be contacted to verify that the UCC terminations were authorized by such secured parties. A letter or email from each such prior secured party confirming that their UCC terminations were authorized would be a conservative requirement. In those cases in which it is not clear that the filed terminations were authorized by the secured party, it would be desirable to have the prior secured party authorize you to terminate their filings.

As indicated above, even more due diligence is necessary if the debtor itself filed the UCC termination. In such case, it is suggested that the secured party issue a letter to you confirming that the secured debt has been paid in full, and authorizing you to terminate all UCC filings filed by such secured party. Moreover, new UCC

terminations are recommended since the debtor may or may not have been qualified to file the termination itself under Code Section 9-513.

c. If there is more than one secured party of record on a UCC filing (whether named in the initial filing or added by later amendment or the result of an assignment of the UCC to one or more assignees), all secured parties of record must file an authorized UCC termination of such filing. As noted above, there are extra risks involved when a UCC was previously assigned, and it is not 100% clear on the face of the UCC assignment that a full assignment was intended from the secured party to the assignee.

d. As indicated earlier, if an existing secured party of record subsequently merged into another entity, such successor entity is authorized to terminate the UCC filed by the secured party of record under Code Section 9-509.

This article is informational in nature and is not intended to constitute, nor should it be relied upon as, legal advice to any recipient.

Bennett L. Cohen, Esq.

About the Author

Bennett L. Cohen is a partner in the law firm of Cohen, Salk & Huvad, P.C. Bennett concentrates his practice in secured lending. He regularly represents banks, commercial finance companies, insurance companies and other institutional lenders in the structuring, documentation and closing of secured lending transactions, including asset-based loans, commercial loans, commercial real estate mortgage and construction loans, mezzanine loans, leveraged acquisitions, equipment lease loans and factoring transactions. He served for fifteen years as general counsel to the Midwest Association of Secured Lenders, a trade association of over eighty banks and finance companies located in Chicago and outlying areas. Bennett is a member of the American Bar Association and serves on the ABA Committee on Commercial Financial Services and the ABA Subcommittees on Secured Lending, Loan Documentation and the Uniform Commercial Code. He is a member of the ABA Joint Task Force on Deposit Account Control Agreements, the ABA Model Intercreditor Task Force, and the ABA Joint Task Force on Filing Operations and Search Logic.