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## FISCAL IMPACT REPORT

SPONSOR: Martinez DATE TYPED: 02/13/01 HB 408  
 SHORT TITLE: Uniform Commercial Code - Secured Transactions SB \_\_\_\_\_  
 ANALYST: Rael

### APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY01	FY02	FY01	FY02		
		See Narrative		Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

Securities Division (SD)  
 Economic Development Department (EDD)  
 Workers' Compensation Administration (WCA)  
 Attorney General's Office (AGO)  
 Administrative Office of the Courts (AOC)  
 Articles:

Barkley Clark, *Revised Article 9 of the UCC: Scope, Perfection, Priorities, and Default*. 4 N.C. Banking Inst. 129.  
 Steven O. Weise, *An Introduction to the Revised UCC Article 9*.

### SUMMARY

#### Synopsis of Bill.

The Revised Article 9 of the Uniform Commercial Code was designed to clarify ambiguous provisions in the old Article 9, broadening its scope, make the financing process more efficient, allowing greater use of modern technology, and clarifying the rules for perfection.

- 1. Scope.** 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 the revision. Also, certain kinds of transactions that did not come under Article 9 before, now come under Article 9. These are some of the kinds of collateral that are included in Revised Article 9 that are not in original Article 9: sales of payment intangibles and promissory notes; health insurance receivables; consignments; and commercial tort claims.

- 2. Perfection.** Filing a financing statement remains the dominant way to perfect a security interest in most kinds of property. It is clearer in Revised Article 9 that filing a financing statement will perfect a security interest, even if there is another method of perfection. "Control" is the method of perfection for letter of credit rights and deposit accounts, as well as for investment property. Control was available only to perfect security interests in investment property under old Article 9. A creditor has control when the debtor cannot transfer the property without the creditor's consent. Possession, as an alternative method to filing a financing statement to perfect a security interest, is the only method for perfecting a security interest in money that is not proceeds of sale from property subject to a security interest. Automatic perfection for a purchase money security interest is increased from ten days in old Article 9 to twenty days in Revised Article 9. Attachment of a purchase money security interest is perfection, at least for the twenty-day period, then another method of perfection is necessary to continue the perfected security interest. However, a purchase money security interest in consumer goods remains perfected automatically for the duration of the security interest.
- 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 make two fundamental changes from old Article 9. In old Article 9, the basic rule chooses the law of the state in which the collateral is found as the law that governs perfection, effect of perfection, and a creditor's priority. In Revised Article 9, the new rule chooses the state that is the location of the debtor. Further, if the debtor is an entity created by registration in a state, the location of the debtor is the location in which the entity is created by registration. If an entity is a corporation, for example, the location of the debtor is the state in which the corporate charter is filed or registered. In old Article 9, the entity that is a debtor is located in the state in which it has its chief executive office. These changes in basic choice of law rules will change the place in which a financing statement is filed in a great many instances from the place it would have been filed under old Article 9. At the same time, the location of the debtor establishes a more certain place to perfect than the old rule does. Collateral shifts location much easier than debtors.
- 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. Under Revised Article 9, the only local filing of financing statements occurs in the real estate records for fixtures. Fixtures are items of personal property that become physically part of the real estate, and are treated as part of the real estate until severed from it. It is anticipated that electronic filing of financing statements will replace the filing of paper. Paper filing of financing statements is already disappearing in many states in 1999, as Revised Article 9 becomes available to them. Revised Article 9 definitions and provisions allow this transition from paper to electronic filing without further revision of the law. Revised Article 9 makes filing office operations more ministerial than old Article 9 did. The office that files financing statements has no responsibility for the accuracy of information on the statements and is fully absolved from any liability for the contents of any statements received and filed. Financing statements may, therefore, be considerably simplified. Of significant importance is that there is no longer a signature requirement for a financing statement. Additionally, the financing statement may use "supergeneric" collateral descriptions such as "all assets of the debtor, now owned or hereafter acquired." However, the security agreement itself still requires a clear description of the

collateral pledged. The debtor has an opportunity to file a correction statement to provide additional information to the person reviewing the record.

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. Examples of consumer provisions are: a consumer cannot waive redemption rights in a financing agreement; a consumer buyer of goods who pre-pays in whole or in part, has an enforceable interest in the purchased goods and may obtain the goods as a remedy; a consumer is entitled to disclosure of the amount of any deficiency assessed against him or her, and the method for calculating the deficiency; and, a secured creditor may not accept collateral as partial satisfaction of a consumer obligation, so that choosing strict foreclosure as a remedy means that no deficiency may be assessed against the debtor. 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. These are some of the specific new rules: a secured party (creditor with security interest) is obliged to notify a secondary obligor when there is a default, and a secondary obligor generally cannot waive rights by becoming a secondary obligor; a secured party who repossesses goods and sells them is subject to the usual warranties that are part of any sale; junior secured creditors (subsequent in priority) and lienholders who have filed financing statements, must be notified when a secured party repossesses collateral; and, if a secured party sells collateral at a low price to an insider buyer, the price that the goods should have obtained in a commercially reasonable sale, rather than the actual price, is the price that will be used in calculating the deficiency.

#### Significant Issues.

A significant difference between HB 408 and the Revised Article 9 version recommended by the NCCUSL is that under HB 408, government continues to be exempt from the provisions. Because the nature of the collateral that secured government bonds (i.e. a future stream of revenue), this bill could increase the cost of bond issues.

Additionally, embedded in the UCC Article 9 amendments are provisions that may overrule workers' compensation provisions which presently limit or prohibit the attachment or assignment of rights to compensation benefits on behalf of creditors of the injured worker, and provisions which presently limit the utilization of lump sum settlements.

#### **FISCAL IMPACT**

See Administrative Implications.

#### **ADMINISTRATIVE IMPLICATIONS**

The AOC reports that a cost of \$400 will be necessary will be necessary to update, distribute, and document statutory changes. Additional impact on the judiciary would be proportional to any increase in litigation.

### **TECHNICAL ISSUES**

In order to avoid conflict with the Worker's Compensation Act, the Workers' Compensation Administration recommends a couple of alternative amendments. The WCA has been informed that the NCCUSL does not oppose these amendments.

Insert at the end of Section 55-9-109(d):

- (e) an assignment of a claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. §104(a)(1) or (2), as amended from time to time; or
- (f) an assignment of a claim or right to receive benefits under a special needs trust as described in 42 U.S.C. §1396p(d)(4), as amended from time to time.

### **OR**

Insert at the end of Section 55-9-406, and reletter the subsequent subsections:

- (e) Subsection (d) does not apply to the assignment or transfer of or creation of a security interest in:
  - (1) a claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. §104(a)(1) or (2), as amended from time to time; or
  - (2) a claim or right to receive benefits under a special needs trust as described in 42 U.S.C. §1396p(d)(4), as amended from time to time.

Insert at the end of Section 55-9-408:

- (e) Subsections (a) and (c) do not apply to the assignment or transfer of or creation of a security interest in:
  - (1) a claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. §104(a)(1) or (2), as amended from time to time; or
  - (2) a claim or right to receive benefits under a special needs trust as described in 42 U.S.C. §1396p(d)(4), as amended from time to time.

### **OTHER SUBSTANTIVE ISSUES**

Almost every state has a provision or provisions that make an injured worker's benefits exempt from the claims of creditors, and exempt from attachment, garnishment or execution. The newly revised UCC Article 9 defines "general intangible" to include "payment intangible". The UCC goes on to define a "payment intangible" as "a general obligation under which the account debtor's principal obligation is a monetary obligation." Certainly the employer's obligation to pay workers' compensation benefits is monetary, and the UCC defines an "account debtor" as anyone obligated on a general intangible. So it appears that, whether intentionally or not, workers' compensation benefits may be

“general intangibles” under Article 9. UCC § 9-408 (c) may render any governmental restriction, including statutes and rules of law, ineffective if they restrict or prohibit the assignment, or transfer of, or the creation of a security interest in, a payment intangible (and thus workers’ compensation benefits). Other provisions discharge the obligation of the account debtor (employer) only if they pay (workers’ compensation benefits) to an assignee of benefits. These provisions obviously run afoul the intent of the majority rule that workers’ compensation benefits can not be sold, attached or executed against, because they are intended to provide basic living expenses for workers during recovery from work injury.

Another concern involves any restrictions against lump sum settlements that may exist under state laws. The ability to sell or assign the future income stream represented by workers’ compensation benefits is the power to receive a lump sum, without going through any approval process or review for protection of the best interests of the worker. Since the UCC changes appear to make future workers’ compensation benefits a commodity that can be bought, sold and pledged as security, any restrictions on lump sum settlements that may occur under state law appear to be rendered ineffective.

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