

Commercial Law Newsletter

Joint Newsletter of the Commercial Finance and Uniform Commercial Code Committees



July 1, 2014

Summer 2014

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Joint Report from the Chairs

Dear Members:

The 2014 Business Law Section Spring Meeting in Los Angeles was a huge success. At this meeting, the ComFin and UCC Committees put on six (6) high quality CLE programs. In addition, the meeting offered many networking opportunities. Our Joint Dinner at Rivera was one of the many meeting highlights.

As you know, the Business Law Section (BLS) no longer fully participates in the ABA's Annual Meeting. Instead, the BLS has launched the BLS Annual Meeting. The inaugural BLS Annual Meeting will be held on Thursday, September 11 to Saturday, September 13, 2014, at the Hyatt Regency Chicago. We hope that you plan on attending this meeting.

The inaugural BLS Annual Meeting is modeled much like the familiar format of the BLS Spring Meeting. At the inaugural BLS Annual Meeting, ComFin and UCC are the primary sponsors of seven (7) CLE programs: (1) So You Think You Know What Law Applies to Your Transaction? Avoiding Malpractice and Other Unpleasant Surprises: A Primer on the UN Convention on Contracts for the International Sale of Goods (Thursday, September 11, 8:30-10:00 am); (2) Lions, Tigers, and Bears, Oh My: Navigating Lender Liability in a World That Hates Banks (Thursday, September 11, 3-4:30pm); (3) Take the Fight Outside! Dispute Resolution in Commercial Financing – Protecting the Value of the Deal (Friday, September 12, 9:00-10:00 am); (4) Dispute Resolution and Finance: Did You Even See the Ethics Issues? (Friday, September 12, 11:30 am-12:30 pm); (5) Secured Lending to Series of LLCs: Beware What You Do Not (and Cannot) Know (Friday, September 12, 2:30-3:30pm); (6) Be Careful What You Wish For: Issues for ABL Commitment Letters in Acquisition Financing (Saturday, September 13, 2014, 8:30-10:00 am); and (7) Bitcoin and Electronic Payment Platforms: Commercial Lending Opportunities and Obstacles (Saturday, September 13, 10:30 am-12:30 pm). In addition, the Committees will hold the usual Joint Meeting on Thursday, September 11, 2014, from 11am-12:30 pm, and a joint committee dinner (Maggiano's, 516 N. Clark Street, Thursday September 11 starting with cocktails at 7:00).

As always, our committees and the vast majority of our subcommittees and task forces will be meeting. The entire schedule for the meeting is available on the BLS website. If you are unable to attend the meeting in person, prior to the meeting we will provide dial-in information for the various committee, subcommittee and task force meetings.

In addition to the UCC Spotlight by Stephen Sepinuck and Kristen Adams, this edition of the newsletter includes six (6) diverse articles written by leading scholars and practitioners of commercial law. Of course, we also extend a hearty thanks to the entire CLN Editorial Board for putting this wonderful newsletter together.

Please email either of us if you have any ideas for either of the Committees or wish to participate in any project, subcommittee or leadership role. The Committees have a number of projects underway. Our subcommittees and task forces are very active and always welcome input. Please do not hesitate to volunteer!

We hope you enjoy this issue, and invite you to get involved in your committee(s). In addition, we look forward to seeing many of you in Chicago in September.

Norman M. Powell
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Commercial Finance Committee Chair
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MARK YOUR CALENDARS

July 8, 2014 – 1:00 p.m. to 2:30 p.m. EDT – Perfecting Security Interests in Deposit Accounts, Security Accounts and Other Investment Property (CLE Webinar). Click [here](#) for more information.

July 15, 2014 – 1:00 p.m. to 2:30 p.m. EDT – Negotiating Representations, Warranties and Indemnification Clauses in Technology Agreements (CLE Webinar). Click [here](#) for more information.

July 29, 2014 – 1:00 p.m. to 2:30 p.m. EDT - Is Your Noncompete Enforceable: Tips and Traps in Drafting and Enforcing Non-Compete Agreements (CLE Webinar). Click [here](#) for more information.

July 31, 2014 – 1:00 p.m. to 2:30 p.m. EDT – Negotiating and Structuring Secured Lending Anti-Assignment, Ordinary Course of Business and Best Efforts Provisions (CLE Webinar). Click [here](#) for more information.

August 6, 2014 – 1:00 p.m. to 2:30 p.m. EDT - Prosecution, Defense and Settlement of M&A Stockholder Litigation: A Solution in Search of a Problem (CLE Webinar). Click [here](#) for more information.

September 11-13, 2014 – ABA Business Law Section Annual Meeting – Hyatt Regency Chicago. Click [here](#) for more information.

October 7-8, 2014 – 9:00 a.m. EDT - ABL & Factoring Basics Workshop. Click [here](#) for more information.

Featured Notes

Please join us at the Annual Meeting in Chicago. The Commercial Law Newsletter Editors will be holding a meeting during the Business Law Section Annual Meeting being held on September 11-13, 2014 at the Hyatt Regency Chicago. Current members of the Articles Advisory Board, as well as anyone interested in becoming involved with the Commercial Law Newsletter, whether by suggesting topics, writing articles or assisting with publication, are invited to attend. If you cannot attend in person, please consider joining us by phone. For details regarding meeting time, location and dial-in information, please contact any of the editors as the Annual Meeting gets closer.

Featured Articles

RECENT DEVELOPMENTS: CHOICE OF LAW STATUTES THAT DISPENSE WITH A “REASONABLE RELATION”

By [Scott J. Burnham](#)

The 2001 Revision of Article 1 of the Uniform Commercial Code originally provided that, except in a consumer transaction, parties to a contract were free to include a choice of law clause that designated the law of a state bearing no relation to the transaction. Section 1-301(b)(1) provided in part:

(1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated.¹

States that adopted Revised Article 1, however, rejected this provision, prompting the Uniform Law Commission to withdraw it in 2008 and replace it with a provision that did not change the “reasonable relation” rule of pre-Revision Article 1. Section 1-301(a) now provides:

(a) Except as otherwise provided in this section, when a transaction *bears a reasonable relation* to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties.²

This new provision has been enacted by every state (except Louisiana) in substantially this form.³

Nevertheless, as discussed in Bryon Mulligan’s article below, a handful of states have enacted statutes permitting commercial parties involved in sufficiently substantial transactions to have greater autonomy when choosing a contract’s governing law by eliminating the reasonable relation requirement. For example, the California Civil Code provides:

Notwithstanding Section 1646, the parties to any contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than two hundred fifty thousand dollars (\$250,000), including a transaction otherwise covered by subdivision (a) of Section 1301 of the Commercial Code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not the contract, agreement, or undertaking or transaction bears a reasonable relation to this state. This section does not apply to any contract, agreement, or undertaking (a) for labor or personal services, (b) relating to any transaction primarily for personal, family, or household purposes, or (c) to the extent provided to the contrary in subdivision (c) of Section 1301 of the Commercial Code.⁴

**VIEW CURRENT REPORTS
AND DEVELOPMENTS OF THE
FOLLOWING COMMITTEES
AND TASK FORCES:**

**COMFIN SUBCOMMITTEES
AND TASK FORCES**

- [Subcommittee on Agricultural and Agri-Business Financing](#)
- [Subcommittee on Aircraft Financing](#)
- [Subcommittee on Creditors' Rights](#)
- [Subcommittee on Cross-Border and Trade Financing](#)
- [Subcommittee on Intellectual Property Financing](#)
- [Subcommittee on Lender Liability](#)
- [Subcommittee on Loan Documentation](#)
- [Subcommittee on Loan Workouts](#)
- [Subcommittee on Maritime Financing](#)
- [Subcommittee on Past Chairs Advisory](#)
- [Subcommittee on Programs, Meetings and Communications](#)
- [Subcommittee on Real Estate Financing](#)
- [Subcommittee on Secured Lending](#)
- [Subcommittee on Syndications and Lender Relations](#)
- [ADR Task Force](#)
- [Model Intercreditor Agreement Task Force](#)

**UCC SUBCOMMITTEES AND
TASK FORCES**

- [Subcommittee on Annual Survey](#)
- [Subcommittee on Article 7](#)
- [Subcommittee on Commercial Law Newsletter](#)
- [Subcommittee on General Provisions and Relations to Other Law](#)
- [Subcommittee on International Commercial Law](#)
- [Subcommittee on Investment Securities](#)
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- [Subcommittee on Secured Transactions](#)

New York,⁵ Illinois,⁶ and Florida⁷ have enacted substantially the same rule. Many of these jurisdictions have simultaneously liberalized their choice of forum rules to attract business by providing access to their courts as a forum for dispute resolution.⁸

In Ohio, the provision is enforceable without monetary limit, but only when the defendant is foreign and when the contract contains both a choice of law clause and a choice of forum clause:

(A) Except as provided in division (C) of this section, any person may bring a civil action in a court of this state against an individual, corporation, or other person who is a resident of, incorporated under the laws of, or otherwise engaged in the conduct of business in a foreign nation or a province, territory, or other political subdivision of a foreign nation, against a foreign nation, or against a province, territory, or other political subdivision of a foreign nation upon a cause of action that arises out of or relates to a contingent or other contract, agreement, or undertaking, whether or not it bears a reasonable relation to this state, if the contract, agreement, or undertaking contains both of the following provisions:

(1) An agreement by the parties to be governed in their rights and duties under the contract, agreement, or undertaking, in whole or in part, by the law of this state;

(2) An agreement by the parties to submit to the jurisdiction of the courts of this state.⁹

In Delaware, a contractual clause choosing Delaware law is enforceable if the parties are “(i) subject to the jurisdiction of the courts of, or arbitration in, Delaware and, (ii) may be served with legal process.”¹⁰ The amount of money involved must be at least \$100,000.¹¹

In Texas, a complex series of provisions modifies the reasonable relation rule. Business and Commerce Code § 271.004(a) provides that “a transaction bears a reasonable relation to a particular jurisdiction if the transaction, the subject matter of the transaction, or a party to the transaction is reasonably related to that jurisdiction.”¹² Subsection (b)(1) then enumerates the general factors that constitute a reasonable relation to the jurisdiction¹³ while subsection (b)(2) enumerates a specific transaction that requires even less of a relation:

(2) a transaction in which:

(A) all or part of the subject matter of the transaction is a loan or other extension of credit in which a party lends, advances, borrows, or receives, or is obligated to lend or advance or entitled to borrow or receive, money or credit with an aggregate value of at least \$25 million;

(B) at least three financial institutions or other lenders or providers of credit are parties to the transaction;

(C) the particular jurisdiction is in the United States; and

(D) a party to the transaction has more than one place of business and has an office in that particular jurisdiction.¹⁴

Section 271.005 provides that the parties to a transaction with a value of at least \$1 million may choose the law of a jurisdiction that bears a reasonable relation to that jurisdiction, as defined in the previous section.¹⁵

Section 271.006 provides that the parties to a \$1 million transaction may choose the law of a jurisdiction to which the transaction does not bear a reasonable relation, but only for the purpose of “interpretation or construction” of the agreement.¹⁶

Returning to § 271.005, one may be struck by an unusual provision purporting to circumvent judicial inquiry as to whether the chosen law violates public policy:

COMFIN AND UCC JOINT TASK FORCES

- [Commercial Finance/UCC Online Discussion Forum](#)
 - [Commercial Finance Terms Joint Task Force](#)
 - [Deposit Account Control Agreements Joint Task Force](#)
 - [Filing Office Operations and Search Logic Joint Task Force](#)
 - [Legislative Enactment of Article 9](#)
 - [Model IP Security Agreement Joint Task Force](#)
 - [Security Interests in LLC and other Unincorporated Entity Interests Joint Task Force](#)
 - [Survey of Commercial Lending Laws](#)
-

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- [Uniform Commercial Code Committee](#)
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-

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(b) The law of a particular jurisdiction governs an issue described by this section regardless of whether the application of that law is contrary to a fundamental or public policy of this state or of any other jurisdiction.¹⁷

To understand this provision, recall that under the prevailing rule, the forum court may refuse to enforce the parties' chosen law if, as stated in Restatement (Second) of Conflict of Laws:

application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.¹⁸

This exception raises some interesting issues. A forum court usually invokes the fundamental policy exception when its own law would otherwise apply and the substantive law of the chosen jurisdiction is contrary to its own law. However, in *Supply & Building Co. v. Estee Lauder International, Inc.*,¹⁹ the Southern District Court of New York refused to apply the exception in the face of the New York statute dispensing with the reasonable relation. The court interpreted a provision in an agreement between a New York company and a Kuwaiti company that specified "the Laws of the United States" as the governing law to mean the parties contracted for New York law.²⁰ On motion for reconsideration, the Kuwaiti company argued for application of the fundamental policy exception on the grounds that Kuwaiti law on the substantive issue differed from New York law. In denying the motion, the court stated:

[General Obligations Law] [s]ection 5-1401 is a broad choice of law provision clearly written to leave no doubt that New York substantive law applies when it is provided for in certain contracts. New York has a strong public policy interest in upholding a choice of law provision that requires the substantive law to be New York. Therefore, because the clear provisions of section 5-1401 make no exception for a foreign state's public policy, the Court denies S&B's motion for reconsideration.²¹

This opinion reaches the right result, but is problematic for numerous reasons. First, the parties did not provide for New York law. Second, even if they had, § 5-1401 would not be relevant because the transaction bore a reasonable relation to New York. Third, even if § 5-1401 applied, the fundamental policy exception would probably be read in.²² Finally, if the court had addressed the fundamental policy exception, it would probably have found it inapplicable because Kuwait would not be "the state of the applicable law in the absence of an effective choice of law by the parties" under the Restatement test.²³

Is it possible that a statute dispensing with the reasonable relation requirement could itself be challenged as contrary to a fundamental policy? In theory, a forum court in a state lacking such a statute could find that its state's policy, as found, for example, in UCC § 1-301(a), requires that the chosen law bear a reasonable relation to the transaction. It could therefore find that the law of the chosen jurisdiction is contrary to its policy because the law of that jurisdiction permits the parties to choose law that has no reasonable relation to the transaction.

Further litigation will no doubt explore the parameters of these statutes.

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WRITE FOR AN OFFICIAL ABA PUBLICATION?**GET PUBLISHED, WITHOUT TOO MUCH OF A TIME COMMITMENT?****CONNECT WITH OTHER MEMBERS OF THE UCC OR COMFIN COMMITTEES?**

If so, submit an article for possible publication in a future issue of the Commercial Law Newsletter. Publishing an article with the Commercial Law Newsletter is a great way to get involved with the UCC Committee and the ComFin Committee. Articles can survey the law nationally or locally, discuss particular UCC or Commercial Finance issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the following Commercial Law Newsletter Editors [Celeste B. Pozo](#), [Hilary Sledge](#), [Glen Strong](#), [Christina B. Rissler](#), [Suhuyini Abudulai](#) or [Sidney Simms](#).

By [Bryon J. Mulligan](#)**A. Introduction**

Many commercial contracts have a provision that designates the law of a particular jurisdiction (the jurisdiction so designated will be referred to herein as the “Chosen State”) to govern the interpretation of the relevant contract and, in some cases, all disputes that may arise out of the transactions governed by that contract, whether based on contract, tort or otherwise. This type of provision is commonly referred to as a “chosen-law clause.” The following is an example of a chosen-law clause that is broadly worded:

This Agreement and any claim, controversy, dispute or cause of action (whether in contract or tort or otherwise) based upon, arising out of or relating to this Agreement and the transactions contemplated hereby shall be governed by, and construed in accordance with, the law of the State of New York.²⁴

In general, whether a chosen-law clause is enforceable depends on whether the transaction bears a reasonable relationship to the Chosen State²⁵ or whether the application of the law of the Chosen State would be contrary to a fundamental policy of another state which has a materially greater interest than the Chosen State in the determination of the particular issue (this analysis will be referred to herein as the “Restatement Test”).²⁶ Certain states, however, have replaced the Restatement Test in situations involving large commercial contracts with a statute that permits the parties to choose the laws of the Chosen State to govern the contract on an unqualified basis, without regard to the parties’ connection to the Chosen State (these types of statutes will be referred to as “Unqualified Chosen-Law Statutes”). Section 5-1401(1) of New York’s General Obligation Law²⁷ is an example of an Unqualified Chosen-Law Statute, which provides as follows:

The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of *this state* shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state. This section shall not apply to any contract, agreement or undertaking (a) for labor or personal services, (b) relating to any transaction for personal, family or household services, or (c) to the extent provided to the contrary in subsection two of section 1-105 of the uniform commercial code.²⁸

This article explores the following questions about Unqualified Chosen-Law Statutes: (i) whether an Unqualified Chosen-Law Statute of one state is applicable in court proceedings in other states, (ii) whether there is an implied public policy exception to Unqualified Chosen-Law Statutes, and (iii) whether a chosen-law clause within the scope of an Unqualified Chosen-Law Statute is applicable to tort claims arising out of the transaction.

B. Applicability of Unqualified Chosen-Law Statute in Other States

In general, the policy rationale for the enactment of Unqualified Chosen-Law Statutes is to encourage parties with multi-jurisdictional contacts to avail themselves of the laws of the Chosen State for large commercial contracts by creating certainty that the law of the Chosen State will be applied to the particular transaction by the courts of the Chosen State. In New York, another concern expressed in justifying its statute was that the potential for a New York court not to apply New York law to contracts expressly governed by New York law would adversely “affect the standing of New York as a commercial and financial center.”²⁹ Other states may have similar motivations. Thus, the main purpose of an Unqualified Chosen-Law Statute is to create certainty that a state’s own courts will apply the law of that particular state when the parties to large commercial contracts chose the law of that particular state to govern their contracts.

If a contract with a chosen-law clause is enforced in the courts of a state that is *not* the Chosen State (in which case the court is being asked to apply the law of another state), the court will apply traditional conflict of law analysis (typically the Restatement Test) in determining whether the laws of the Chosen State should apply. In such cases (assuming the Restatement Test is applied), the chosen-law clause would not be upheld (and the laws of the Chosen State would not be applied to the contract) if the court determines that the transaction does not bear a reasonable relationship to the Chosen State or if the application of the law of the Chosen State would

be contrary to a fundamental policy of a state the court determines has a materially greater interest than the Chosen State in the determination of a particular issue.³⁰

Therefore, if the parties to a commercial contract within the scope of an Unqualified Chosen-Law Statute wish to have the Unqualified Chosen-Law Statute apply to the contract, they must litigate their disputes in the courts of the Chosen State. To ensure at the outset of the contractual arrangement that any disputes arising out of such contract will be litigated in the courts of the Chosen State, the parties should include in the contract forum selection and submission to jurisdiction clauses, under which the parties agree to the *exclusive* jurisdiction of the Chosen State. Otherwise, a party could bring suit in another jurisdiction that might not apply the laws of the Chosen State to the contract.

C. Implied Public Policy Exceptions to Unqualified Chosen-Law Statutes

One of the exceptions to the Restatement Test is the public policy exception. Under this exception, if the court determines that the application of the laws of the Chosen State would be contrary to a fundamental policy of another state which has a materially greater interest in the determination of the particular issue, the court would apply the law of the other state to the determination of that issue. For example, if the interest rate in a loan agreement is not usurious under the laws of the Chosen State, but is usurious under the laws where the parties to the loan agreement are domiciled, and the parties have no connections with the Chosen State, under the public policy exception, a court could apply the usury laws of the state where the parties are domiciled because that state has a greater interest in the determination of whether a particular interest rate is usurious.

Unqualified Chosen-Law Statutes do not have any express qualifications (including the public policy exception) to the enforceability of chosen-law clauses that fall within the scope of these statutes. Therefore, a court would need to imply the public policy exception into its state's Unqualified Chosen-Law Statute if the court wished to invoke the exception to override the parties choice of law in a contract. Whether a public policy exception should be implied in Unqualified Chosen-Law Statutes raises conflicting policy concerns.

The argument against implying a public policy exception is that the exception would substantially undercut the purpose of the statute, and would be contrary to the intent of the state legislature that has enacted a particular Unqualified Chosen-Law Statute. As noted above, Unqualified Chosen-Law Statutes are intended to create certainty that the courts of the Chosen State will apply the law of the Chosen State in contract disputes involving relatively large commercial transactions. For a large multinational company with extensive multijurisdictional contacts, the existence of a public policy exception to an Unqualified Chosen-Law Statute could result in considerable uncertainty as to the law that would apply to the contracts of such company. Further, Unqualified Chosen-Law Statutes have generally replaced or superseded statutes with an express public policy exception, in effect removing the public policy exception. If a state legislature had intended to retain the public policy exception, the public policy exception would likely have remained in the statute.

An argument in favor of implying a public policy exception is that not having a public policy exception would require a court to enforce a contract among parties with no connection to the forum state that is illegal in or against a fundamental policy of the state where the contract is to be performed (e.g., a contract that violates usury laws or, in the case of a gambling contract, gambling laws where the contract is to be performed).³¹ A counterargument to this position is that the enforcement of the contract under such circumstances would not prevent the state where the contract is illegal from enforcing its laws, particularly where the contract violates criminal laws. Nevertheless, courts might be reluctant to enforce such a contract in a case where neither the contract nor the parties have any connection to the Chosen State.

Additionally, there is a textual argument for implying a public policy exception. Because most Unqualified Chosen-Law Statutes specifically take exception to the "reasonable relation" component of the Restatement Test and not the "public policy" component (specifically, by the inclusion of the phrase "whether or not such contract, agreement or undertaking bears a reasonable relation to this state"), it may be argued that the intent of a state legislature was not to exclude a public policy exception from such statutes.

The cases that have analyzed this issue so far have not implied a public policy exception in the relevant Unqualified Chosen-Law Statutes unless the chosen-law provision was procured as a result of fraud.³²

D. Applicability of Unqualified Chosen-Law Statutes to Related Tort Claims

Chosen-law clauses typically are drafted to state that the relevant agreement will be governed by the law of the Chosen State. In contract disputes that have reached litigation, it is not uncommon for there to be allegations of fraud, negligence or other tortious conduct related to the formation or performance of the contract. The question then becomes whether a chosen-law clause in the relevant contract that is within the scope of an Unqualified Chosen-Law Statute would compel the application of the law of the Chosen State to any tort claims arising out of the transaction.

The courts in the reported cases addressing this issue have been reluctant to construe contractual chosen-law clauses to include tort

claims that were incident to the contract, but they do undertake an analysis of the chosen-law clause at issue to determine whether the wording of the clause itself was broad enough to encompass tort claims.³³ If the chosen-law clause states that the contract will be governed by the law of the Chosen State, without referencing tort claims, the clause would not compel the application of the law of the Chosen State to the tort claims. However, these cases also suggest that if the chosen-law clauses were broadly drafted, it could encompass tort claims.

The chosen-law clause set forth in Part A of this article, however, is considerably broader than the chosen-law clauses described in the cases, providing that “any claim, controversy, dispute or cause of action (*whether in contract or tort or otherwise*) based upon, arising out of or relating to this Agreement . . . shall be governed by, and construed in accordance with, the law of the State of New York.” Thus, the scope of this choice of law provision expressly includes any tort claims arising out of or related to the transaction and therefore, a court might find it effective to cover tort claims, despite the courts’ reluctance not to do so. If the parties to the contract desire to have all controversies arising out of contract, including those sounding in tort, to be determined under the laws of the Chosen State, the chosen-law clause would need to be much broader than those construed in the cases.³⁴

E. Conclusion

If the parties to a large commercial contract designate in a chosen-law clause a Chosen State with an Unqualified Chosen-Law Statute, the parties’ designation should be enforceable in the courts of the Chosen State without regard to the parties’ connection to the Chosen State or the public policy of another jurisdiction (subject to possible limitations under the United States constitution that may apply). However, if a contract is enforced in a state that is not the Chosen State, the courts of that state will apply the Restatement Test to the parties’ designation and will not enforce it if the transaction does not bear a reasonable relationship to the Chosen State or if, as to a particular issue, the application of the law of the Chosen State to that issue would be contrary to a fundamental policy of another state which has a materially greater interest than the Chosen State in the determination of the issue. In addition, to ensure that all claims (including tort claims) arising out of the transaction are governed by the laws of the Chosen State, the parties to the transaction should ensure that the chosen-law clause is drafted to expressly cover all causes of action (whether in contract or tort or otherwise).

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PROPOSED AMENDMENTS TO THE UNIFORM VOIDABLE TRANSACTIONS ACT (currently known as the Uniform Fraudulent Transfer Act)

By [Edwin E. Smith](#)

The Uniform Fraudulent Transfer Act (the “Act”) addresses certain transfers of property and incurrences of obligations that violate norms of the debtor-creditor relationship. The Act provides for avoidance of a transfer of property or the incurrence of an obligation that is made by a debtor with intent to hinder, delay, or defraud any creditor of the debtor. The Act also provides for avoidance of a transfer or incurrence, regardless of the debtor’s intent, if the debtor receives less than reasonably equivalent value in exchange for the property or obligation and afterwards the debtor is insolvent, is unable to pay the debtor’s debts as they become due, or is left with unreasonably small capital to operate the debtor’s business or conduct its other activities. The Act is the latest of successive codifications of this area of the law, beginning with the English enactment in 1571 of the Statute of 13 Elizabeth. In this country the first uniform law on the subject was the Uniform Fraudulent Conveyance Act, promulgated by the Uniform Law Commission in 1918. The Act was promulgated by the Uniform Law Commission in 1984 to replace the Uniform Fraudulent Conveyance Act with a statute more consistent with the then recently enacted federal Bankruptcy Code. The Act has been enacted in forty-three states and the District of Columbia.

The Act affords a creditor a remedy under state law if the creditor’s debtor makes an inappropriate transfer of property or incurs an inappropriate obligation and the debtor is not subject to a bankruptcy case. The Act is also relevant if the debtor is subject to a bankruptcy case. Although the Bankruptcy Code contains its own fraudulent transfer provision in § 548, the bankruptcy trustee under § 544(b) of the Bankruptcy Code may also set aside a transfer of property or the incurrence of an obligation which an actual creditor of the debtor may set aside under state law. Under *Moore v. Bay*, 284 U.S. 4 (1931), the result of setting aside the transfer or incurrence under § 544(b) is not limited to the amount of the actual creditor’s claim, and the recovery inures to the benefit of the bankruptcy estate rather than to that creditor alone. Moreover, the look-back period under § 548 is generally two years from the time of the transfer or incurrence, while the look-back period under the Act is generally four years.

It is likely that this summer the Uniform Law Commission will approve amendments to the Uniform Fraudulent Transfer Act that will, among other things, change the name of the Act to the Uniform Voidable Transactions Act. The amendments culminate a three-

year process that began with a study committee in 2011 and continued with a drafting committee for an approximate two-year period. Upon approval by the Uniform Law Commission, the amendments will be introduced in state legislatures throughout the country. The current draft of the amendments may be found on the Uniform Law Commission's web site, www.uniformlaws.org.

The following is a brief summary of the amendments:

Change of Terminology. The Act has always provided for the avoidance of a transfer of property or the incurrence of an obligation by a debtor if the debtor's intent was to hinder or delay any creditor of the debtor. The debtor need not have intended to defraud any creditor in order for the transaction to be avoidable under the Act. As originally written, the Act used inconsistent words to refer to a transfer or obligation for which the Act provides a remedy: sometimes "voidable" and sometimes "fraudulent." The amendments substitute the word "voidable" for "fraudulent," both as a matter of consistency and to emphasize that intent to defraud is not required in order for the Act to provide a remedy.

The Official Comments point out that the Act does not cover the entire subject of voidable transfers and obligations and that the change of terminology does not affect other law, such as law dealing with third-party liability for aiding and abetting or civil conspiracy, rules of professional conduct for a lawyer who facilitates a transfer or obligation voidable under the Act, the crime-fraud exception to attorney-client privilege applicable to communications between a lawyer and a client relating to a transfer or obligation voidable under the Act, or criminal sanctions for facilitating or making a transfer or obligation voidable under the Act.

Change of the Title of the Act. Likewise, the amendments change the title of the Act from the "Uniform Fraudulent Transfer Act" to the "Uniform Voidable Transactions Act." The change reflects that a transfer of property or the incurrence of obligation need not be fraudulent for the Act to provide a remedy. It also reflects that the Act applies to the incurrence of an obligation as well as to a transfer of property.

Burdens and Standards of Proof. States have applied different burdens and standards of proof in fraudulent transfer litigation. The amendments seek to provide uniformity among the states in this area. The Act places the burden on the creditor to prove the elements of a voidable transaction under the Act and the burden on the debtor to prove the elements of a defense to a voidable transaction under the Act. Consistent with the theme that a transfer of property or the incurrence of an obligation need not be fraudulent for the Act to provide a remedy, the Act provides for a "preponderance of the evidence" standard of proof. The Act as amended thus avoids the "clear and convincing" standard that courts in some states have applied under the Act, based on inappropriate analogy to the standard typically applied to claims of common-law fraud.

Choice of Law. Courts have applied different theories to determine which jurisdiction's voidable transactions law should apply to a transfer of property or the incurrence of an obligation. The different theories are explored in Kenneth C. Kettering, *Codifying a Choice of Law Rule for Fraudulent Transfer*, 19 Am. Bankr. Inst. L. Rev. 319 (2011). In order to provide some uniformity to the resolution of the choice of law issue, both for planning transactions and in reducing the costs of litigating them, the Act provides a choice of law rule that looks to the location of the debtor at the time when the transfer of property or the incurrence of the obligation was made or incurred. An individual is considered to be located at his or her primary residence. An organization is considered to be located at its place of business or, if it has more than one place of business, at its chief executive office. Section 6 of the Act, which has not been materially altered by the amendments, provides rules for determining the time of occurrence of a transfer of property or the incurrence of an obligation for purposes of the Act, including the new choice of law rule.

The Official Comments strongly encourage courts to be on the lookout for "asset tourism" by which a debtor changes location to a new jurisdiction to take advantage of debtor friendly laws in the new jurisdiction. The Official Comments emphasize that any change of location must be genuine and not merely transitory for purposes of manipulating the choice of law rule.

The choice of law rule cannot and will not resolve all choice of law problems for voidable transactions of the sort governed by the Act. Not all states have adopted even the current Act. It is possible that a dispute over a voidable transaction may arise in a jurisdiction that has not enacted the Act inclusive of the amendments. Moreover, in a bankruptcy case the choice of law rules are uncertain as a matter of federal law. The Supreme Court has never stated what choice of law rule a bankruptcy court should apply to an issue governed by state law, and lower courts are much divided on the issue. Some bankruptcy courts apply the choice of law rule of the forum jurisdiction, some apply a uniform federal choice of law rule and still others apply the choice of law rule of the forum jurisdiction unless a federal interest requires the application of a different choice of law rule. Still, the Act's choice of law rules may be instructive to courts that would otherwise consider applying a different choice of law rule.

Determination of "Insolvency." In determining whether a debtor was insolvent when a transfer of property was made or an obligation was incurred, the Act clarifies that the debtor's debts, in addition to the debtor's assets, must be valued at a fair valuation. The Official Comments point out that a contingent debt should be valued based on the likelihood that the contingency would occur and further note that trading values or accounting valuations should not be used. For example, consider a non-contingent debt owed by the debtor with a face amount of \$100 and trading at a price of \$60. Even though the debt has a value in the market place of \$60, the debtor still owes \$100 on the debt. The debt should be valued at \$100.

The existing Act also contains a presumption that a debtor is insolvent if the debtor is not generally paying the debtor's debts when due. There is no similar presumption in the Bankruptcy Code. The amendments move into the statute two points currently appearing only in the Official Comments: that a debt that is subject to a bona fide dispute should not be counted as debt for this purpose and that, if the presumption on insolvency goes into effect, the result is to shift the burden of persuasion on solvency to the transferee.

Furthermore, the amendments delete the special rule in the existing Act by which the net worth of a general partner of a partnership debtor is included as an asset of the debtor in determining the solvency of the debtor. The special rule has no justification in current practice. While the existing Act seems to treat a general partner as analogous to a guarantor of the partnership debts, there is no similar treatment in the computation of the debtor's solvency for net assets of an actual guarantor of the debts of a partnership or, indeed, of any other debtor. In addition, given that a limited liability partnership is typically a general partnership under state law, but a general partner of a limited liability partnership is not generally liable for the partnership's obligations, it is not appropriate to count the net worth of a general partner of a limited liability partnership in determining the partnership's solvency.

Defenses. The amendments modify defenses in the existing Act in several relatively minor respects.

The existing Act provides a complete defense, not found in the Bankruptcy Code, to the transferee of a transfer made with intent to hinder, delay or defraud any creditor of the debtor if the transferee acted in good faith and gave reasonably equivalent value. Resolving a split in the case law, the amendments provide that, for the transferee to qualify for the defense, the reasonably equivalent value must be given *to the debtor*.

The existing Act affords a subsequent transferee a defense if the transferee took in good faith and for value and affords a subsequent transferee from that transferee a like defense, but in each case only to an action on a money judgment. The amendments provide that the defense in each case would also apply to a recovery of or from the transferred property of its proceeds, by levy or otherwise. The change would make the defense consistent with §§ 550(a) and (b) of the Bankruptcy Code.

The existing Act creates a defense for a "constructively" voidable transfer (i.e., a transfer that is voidable for reasons other than intent by the debtor to hinder, delay or defraud any creditor of the debtor) if the transfer resulted from the enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code. The amendments exclude from that defense a so-called "strict foreclosure," i.e., an acceptance by the secured party of collateral in whole or partial satisfaction of the secured obligations under UCC § 9-620. The protection of a strict foreclosure from a voidable transfer challenge is not appropriate if the secured party accepts collateral having a value in excess of the secured obligations and afterwards the debtor was insolvent, the debtor was unable to pay the debtor's debts as they became due, or the debtor was left with unreasonably small capital. Unlike enforcement by way of collection under UCC § 9-607 or disposition under UCC § 9-610, in a strict foreclosure there is no requirement that the secured party act in a commercially reasonable manner. Moreover, in the case of a strict foreclosure there may not be another secured party or lien holder notified of, and entitled to object to, the secured party's acceptance of collateral having a value in excess of the secured obligation.

Series Organizations. The existing Act does not address "series organizations," which have emerged as a common form of business organization. The amendments treat each series of a series organization as a separate person for purposes of the Act, so that a transfer of property or an incurrence of an obligation by a series in favor of another series or the series organization itself is subject to the provisions of the Act.

Medium Neutrality. In order to accommodate electronic commerce and electronic storage of data, the amendments replace references in the Act to a "writing" with references to a "record," with related changes being made in the definitions.

Official Comments. The Official Comments to the Act have been expanded to explain the provisions added by the amendments. In addition, the original comments and Prefatory Note have been supplemented and otherwise refreshed. For example, the Official Comments explain why creditors are not prejudiced by the transfer of assets of a growing business into a limited liability organization if no financial distress exists or is anticipated, while creditors of a debtor might be prejudiced if, anticipating financial distress, the debtor converted shares in the debtor's corporation to interests in a limited liability company for which lien creditor remedies are more limited. As another example, the Official Comments explain that "avoidance" of an obligation means that the obligation is subordinated in favor of the creditor rather than the obligation ceasing to exist.

Transition. The amendments provide for no uniform effective date. However, a legislative note encourages the enacting legislation to provide that the amendments apply to a transfer of property or the incurrence of an obligation that becomes effective, as determined under § 6 of the Act, on or after the effective date of the amendments.

[Edwin E. Smith](#), a partner at Bingham McCutchen LLP, was the chair of the drafting committee for the amendments to the Uniform Voidable Transactions Act. Professor Kenneth C. Kettering was the reporter and provided helpful comments for this article. The American Bar Association Advisor was Patricia A. Redmond. Jay David Adkisson, Daniel S. Kleinberger, Charles D. Schmerler, James J. Schneider and David J. Slenn served as Section Advisors. A number of the members of the Commercial Finance and Uniform Commercial Code Committees participated in the project.

THE HAZARDS OF LENDING TO BITCOIN USERS

By [Pamela J. Martinson](#) and [Chris Masterson](#)

Many businesses and consumers have taken an interest in emerging payment systems, such as Bitcoin. Such systems present overlooked legal issues for creditors, particularly with respect to perfection of security interests and recovery of collateral.

Some of these systems may provide the opportunity for borrowers to quickly—and potentially irreversibly—transfer collateral funds. Creditors and their legal counsel need to understand emerging payment systems to realize the collateral value present in these systems, and to prevent the loss or transfer of collateral away from the creditor's control, in each case through careful due diligence and attention to drafting the loan documents.

Money transmitters serve as middlemen transferring money between buyers and sellers. Users of the newest electronic platforms fund transactions either by linking a bank account or credit card to their account on the platform or by loading funds directly into such account. The accumulation of funds on the platform offers a source of collateral for the user's creditors. Although a money transmitter may hold funds for its users, in at least one well-known instance, the FDIC has indicated the money transmitter is not acting as a "bank" for purposes of federal banking laws.³⁵

Creditors wishing to take collateral as security for their loans perfect that security interest under the applicable state's version of Article 9 of the Uniform Commercial Code which governs security interests in personal property (i.e., collateral that is not real estate). Under the UCC, a creditor in a commercial transaction perfects a security interest in a deposit account by having "control" over that account.³⁶ This is usually accomplished when the debtor, the debtor's bank and the creditor sign a deposit account control agreement. However, if the platform is not a bank, the accounts are not "deposit accounts" as defined in the UCC.³⁷ Instead, such accounts could be more appropriately characterized as "payment intangibles" under the UCC, which requires a creditor to file a UCC-1 financing statement with the appropriate state authority.³⁸

Relying on a UCC-1 rather than a control agreement means a creditor does not have the advance agreement of the debtor's bank allowing it to quickly remove funds from the debtor's account. Thus, it takes more time and expense for a creditor to recover funds from a payment platform account as compared to an actual bank deposit account.

Careful due diligence may uncover cash maintained by a borrower on payment platforms. Lending documents may contain clauses restricting or limiting amounts held on a platform and representations and warranties that platform accounts are to be used in the ordinary course of business only.

Bitcoin is a fast-growing, software-based system that enables users to transfer payments between one another like other money transmitters. The payments are denominated in bitcoins, a digital currency with no central issuer or backer. The Treasury's Financial Crimes Enforcement Network requires Bitcoin exchanges and processors to register as money services businesses.³⁹ In addition, several state regulators, including in California and New York, have issued interpretations or regulations requiring Bitcoin exchanges and service providers to register as or obtain licenses as money transmitters or money service businesses. Otherwise, Bitcoin is a largely unregulated payment system. Bitcoin is used in an ever-increasing number of cross-border transactions, thus drawing the focus of transferor's creditors.

Each user has at least one digital Bitcoin "wallet" where funds are stored. Funds are obtained as a reward for serving as a "miner" (i.e., allowing the network to use your computational resources), by purchasing Bitcoin on a currency exchange or by selling goods and services for Bitcoins. All Bitcoin transactions are recorded on a decentralized, public ledger called the "blockchain." However, users remain anonymous and transactions are irreversible by system design. As a result it can be difficult or impossible for creditors to discover who is conducting transactions or shifting funds.

Owned Bitcoin has the potential to be collateral for loans, but creditors are likely more concerned with restricting Bitcoin acquisition or use by borrowers due to the uncertain regulatory landscape, irreversible nature of payments, extreme volatility of value and anonymity of the system. Thus, credit agreements may contain covenants prohibiting borrowers from using or accepting Bitcoin, or operating Bitcoin accounts. In addition, diligence questionnaires and credit agreements may contain representations and warranties that the borrower does not use or accept Bitcoin, nor does the borrower have a Bitcoin wallet. Such provisions are just beginning to appear in credit agreements when use of an emerging payment system is apparent.

Perfecting a security interest in Bitcoin is challenging. Identifying the appropriate wallet may be difficult or impossible due to the system's anonymity. Bitcoin is not tangible and therefore it does not appear possible to perfect by possession, nor is a Bitcoin wallet a bank deposit account, meaning it does not appear possible to perfect by control either. Instead, if a wallet is identified, the collateral description in the security agreement should be broadened to cover it, and the security interest perfected by filing a UCC-1 Financing

Statement. Should a borrower transfer collateral funds out of a Bitcoin wallet, it is likely impossible for a creditor to recover since transactions cannot be reversed. Once again, without a control agreement, the option of sweeping the Bitcoin wallet is not available.

It remains to be seen if Bitcoin becomes widely adopted. However, as it and other payment systems evolve, creditors may find they hold valuable collateral for traditional lending transactions.

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GOVERNMENTALLY MANDATED STANDBY LETTERS OF CREDIT: UPDATE

By [Janis Penton](#) and [Jacob A. Manning](#)

Federal, state, and local governments frequently allow standby letters of credit to be used to support a variety of obligations. Typically, those agencies become beneficiaries of the letters of credit and require that the letters of credit be issued in a mandated form that the agency drafts and includes in applicable statutes, regulations or ordinances.

The drafters of those forms are often unfamiliar with letter of credit law and practice and may simply copy a form used by another agency or draft a form without consulting someone familiar with this area of law. The results are letters of credit that are unclear, incomplete, unnecessarily burdensome and, worse still, insufficient to protect the beneficiary of the letter of credit—the very agency that dictates the terms of the form.

A project led by the Institute of International Banking Law & Practice, a non-profit educational organization, seeks to offer some guidance to these agencies. It has formed a Task Force of attorneys, bankers, and governmental representatives, which has met to discuss the issues common to these forms and to consider a draft of a model form that could be used by the governmental agencies in lieu of their existing forms. This article will summarize some of the issues that commonly arise with these governmentally mandated forms and summarize the work that has been and will be undertaken by the Task Force. The Task Force also is seeking help from members of the ABA's UCC Committee in identifying instances of governmentally mandated forms and bringing them to the Task Force's attention.

Nature of the Problem

A comprehensive analysis of all of the issues that arise in governmentally mandated standby letters of credit is beyond the scope of this article. Indeed, conservative estimates are that there may be thousands of such forms in existence. No single article could attempt to explain every issue with every form. Instead, what this article attempts to do is explain some of the reasons that governmentally mandated forms are problematic and give examples of those.

First, it is apparent that many governmental entities are simply inexperienced with letter of credit rules and practice and—perhaps deliberately or perhaps not—choose rules of practice that are not ideal for standby letters of credit. Most commercial letters of credit are issued subject to the Uniform Customs and Practice for Documentary Credits's ("UCP") most recent revision, UCP600.⁴⁰ The UCP was drafted to apply to commercial letters of credit and was oriented towards paying for the sale of goods. As a result, the UCP addresses the examination of documents presented in international trade such as bills of lading, drafts, other types of shipping documents, commercial invoices, and packing lists—documents which are not often found in a standby letter of credit transaction.

Although the UCP can be applicable to standby letters of credit,⁴¹ it does not state how its articles should be applied—or modified to apply—to standby letters of credit. For that reason, among others, under the auspices of the Institute of International Banking Law & Practice, Inc., the International Standby Practices were developed in 1998 ("ISP98"). ISP98 became effective in 1999 and has been endorsed by the International Chamber of Commerce and designated Publication No. 590.

ISP98 was developed for use with standby letters of credit. Thus, it articulates standard international standby letter of credit practice, and it avoids some of the problems created by interpreting a standby letter of credit subject to UCP600. By way of example, ISP98 addresses force majeure,⁴² the dates of documents,⁴³ and installment or partial drawings⁴⁴ in a way that is more attuned to standby letter of credit practice than does UCP600. It also anticipates some issues common to standby letter of credit practice.⁴⁵

Unfortunately, many governmentally mandated standby letters of credit⁴⁶ are still issued subject to UCP600⁴⁷ instead of ISP98 or offer parties a choice between the two. Some do not even invoke any practice rules or instead include only a choice of law clause or a

reference to Revised Article 5 of the UCC.⁴⁸ The choice between these rules of practice is significant. As such, if governmental agencies are choosing to apply UCP600 because they are unaware of ISP98, education as to the differences would be beneficial both to those agencies and the parties that seek to do business with them.

Second, some governmentally mandated standby forms evidence a misunderstanding of the nature of a letter of credit and particularly, the issuer's obligations. A letter of credit is a "definite undertaking . . . by an issuer to a beneficiary at the request or for the account of an applicant, or in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or deliver of an item of value."⁴⁹ "A letter of credit is revocable only if it so provides."⁵⁰ It should not be necessary to state that a letter of credit is "irrevocable" but many governmentally mandated standbys do.⁵¹ The same can be said of the need to state that a letter of credit is "independent."⁵²

Many standby forms go further than using unnecessary words such as "irrevocable" or "independent." ISP98 provides a list of redundant or otherwise undesirable terms, including several that are to be disregarded if they appear in the text of a standby.⁵³ For example, it is quite common for standby letters of credit to state that they are "unconditional," "absolute," and "primary," despite that these words are unnecessary.⁵⁴ And it is common for standby letters of credit to use the words "assignable," "evergreen," or "revolving" despite that these terms have no single accepted meaning and are to be disregarded under ISP98.⁵⁵

Whether these terms are being used in standby letter of credit forms to convey something about the nature of the issuer's obligation under the letter of credit or simply out of habit or because they have been copied from another form, there are clearer alternatives that could be used in each case to describe the obligation.

Third, and finally, some agencies clearly have not thought through the drafts of their form standby letters of credit to the degree that a practitioner would. These forms are problematic not only from the standpoint of the issuer being asked to issue the letter of credit, but also from the standpoint of the governmental agency as beneficiary, which may be disadvantaged by its own drafting decisions.

Examples of such poor drafting abound. If a letter of credit states that its expiration date "shall be automatically extended for a period of at least one (1) year on _____ (date), and on each successive expiration date," exactly when does the letter of credit expire?⁵⁶ If a standby letter of credit indicates without more that it is issued "pursuant to" certain regulations, or that one party's actions or obligations arise "pursuant to" those regulations, what effect do those regulations have on the parties' rights and obligations?⁵⁷ And if a letter of credit is "freely negotiable at any bank" exactly what has an issuer agreed to with respect to that letter of credit?

Again, these are intended only as examples of the issues that have arisen with standby letter of credit forms mandated by governmental entities. Clearly, they are no different than the issues that would arise if any other party unfamiliar with letter of credit law and practice began drafting letter of credit forms. But given the frequency with which these issues arise in forms mandated by governmental agencies, and the importance of the obligations that they support, those issues are worthy of note and of correction where possible.

Organization of the Task Force on Model ISP98 Governmentally Mandated Standbys

In light of these issues and others, in early 2014, the Institute of International Banking Law & Practice ("IIBLP")⁵⁸ formed the Task Force on Model ISP98 Governmentally Mandated Standbys to help draft a model form that these governmental agencies could adopt. The principal drafters of the Model Form are Prof. James E. Byrne, the Director of the IIBLP, and James Barnes, of Baker & McKenzie. The Task Force is co-chaired by Fiore F. Petrassi, of JP Morgan Chase Bank, and Jacob A. Manning, of Dinsmore & Shohl, LLP.

To accomplish its goal of developing a Model Form to be used with ISP98 in situations where a government agency has mandated a form of standby letter of credit, the Task Force has brought together governmental entities such as agencies, departments, and government-owned corporations, private stakeholders such as bankers, lawyers, government contracting firms, and trade associations. The Task Force's work has been organized into three main phases.

First, the Task Force has been meeting by telephone through Spring 2014 to discuss the issues raised by governmentally mandated standbys and, particularly, to consider specific examples of such forms. The Task Force gathered sample forms from around the United States and identified issues common to those forms, and the Task Force has begun discussing how the Model Form may address those issues. The Task Force is taking into account governmental agencies' needs in requiring a standby letter of credit and proposing solutions to the issues created by the forms that still provide the agencies with the security that a standby letter of credit can provide.

In the second phase of the Task Force's work—which the Task Force is just undertaking—the Task Force will call together the various government and private stakeholders to a public meeting at which issues with current forms and the draft of the Model Form can be discussed. The public meeting is intended to provide a forum for all stakeholders to consider the draft Model Form and comment on whether that Model Form could be adopted by governmental agencies in place of existing forms. That meeting took place on June 5-6, 2014, in Washington, D.C.

Finally, in the third phase of the Task Force's work, the Task Force will consider comments made during the public meeting and thereafter, and finalize work on the draft Model Form. The Task Force's goal is to create a Model Form that governmental agencies will find suitable to meet their needs and that private stakeholders are willing to issue. Of course, part of the Task Force's work in that regard will consist of disseminating the Model Form to governmental agencies and advocating its adoption. To this end, the Task Force would appreciate the help of members of the ABA's UCC Committee in identifying governmental entities that either have mandated or plan to mandate a standby letter of credit form and, if possible, provide a copy of the form. The Letter of Credit Subcommittee, through its co-chairs, will act as a clearing house to receive any information and pass it along to the Task Force. The co-chairs are Peter Carson (PCarson@sheppardmullin.com) and Larry Safran (Larry.Safran@lw.com). Forms also may be sent to Janis Penton (janis.penton@unionbank.com), who is acting as a liaison from the Subcommittee to the Task Force.

Ultimately, the success of the project will be determined by the governmental entities that adopt the Model Form. As such, individuals interested in receiving more information or contributing to the success of the project are invited to contact [Jacob Manning](mailto:jacob.manning@dinsmore.com) via email at jacob.manning@dinsmore.com or the Project Director, Nicholas Lawson, via email at nlawson@iiblp.org for more information or to provide assistance in reviewing or disseminating the Model Form.

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CONSIDERATIONS IN NEGOTIATING AGREEMENTS AMONG LENDERS

By [Daniella Garcia](#)

An Agreement Among Lenders or "AAL" governs the rights and obligations of the agent(s) and lenders who provide a unitranche credit facility to a borrower. A unitranche facility combines what would normally be two separately documented credit facilities (whether senior and junior, first lien and second lien, or split-lien revolver and term loan) into a single credit facility. The unitranche facility is governed by one set of documents and is secured by a single lien granted to one of the agents. The AAL takes the place of a traditional intercreditor agreement and will be a confidential agreement not provided to the borrower. A unitranche facility is often preferred by borrowers looking to minimize transaction costs and shorten the time period needed to close. It may also be proposed by the lenders holding the "second-out" portion of the facility when competing to win and then syndicate a deal. In such a scenario the unitranche facility will be structured with blended pricing (i.e., a single interest rate on the entire facility and a single set of fees) allowing the borrower to better compare competing proposals. A unitranche facility will typically not be proposed by the lenders holding the "first-out" portion due to, among other things, the risk in a bankruptcy that the first-out portion of the facility is deemed under-secured. This risk arises due to the fact that there is only one lien securing both the first-out and second-out debt, so the determination of whether the facility is secured or under-secured is made based on the value of the collateral to the entirety of the debt. If the entire facility is deemed under-secured, then the first-out lenders will not receive interest and attorneys' fees accruing after commencement of the bankruptcy regardless of whether the value of the collateral was sufficient to cover all of the first-out obligations.⁵⁹ With competition among lenders becoming more and more fierce, a first-out lender will often accept this risk to avoid losing the deal to a competitor.

The form that an AAL will take is often determined by the second-out lenders, whose counsel will usually draft the agreement. Whether the AAL is more favorable to one set of lenders over the other on any given point often depends on how the deal was put together. If the deal was sourced by the first-out lenders, they may have the leverage to obtain certain benefits under the AAL. If the deal was sourced by the second-out lenders, then the AAL will be more second-out friendly. Further, most AALs are negotiated based on precedent between the two sets of lenders and the terms may be dictated, in part, by the relationship between these lenders. As such, what may be acceptable to one lender may not be acceptable to another similarly situated lender. Any lender looking to syndicate a unitranche facility should bear this in mind.

Given the confidential nature of AALs and the manner in which they are negotiated, no real "market" precedent exists for these types of agreements. That being said, most AALs will address the following issues:

Delineation of the First-Out and Second-Out Obligations. All revolving obligations, including bank products and hedges provided by first-out lenders, will be part of the first-out obligations. If there is a term loan A under the credit documents, it will usually be part of the first-out obligations with all other term loans being part of the second-out obligations. If the underlying credit facility does not have separate term loan tranches, then the term loan may be split into A and B pieces under the AAL.

Payment Priority or "Waterfall." If there are separate term loan tranches in the credit agreement, then typically the credit agreement will govern application of amortization payments, optional prepayments and mandatory prepayments absent a liquidation event. If not, then the AAL will typically provide that all such payments are applied first to the first-out obligations until paid in full and then to the second-out obligations until paid in full. It is also possible that such application will be ratable until certain triggering events occur. Such triggering events may be tied to the borrower's financial performance, regardless of whether they are also events of default under the credit agreement, or excess availability under the revolver.

If the obligations are accelerated or a "waterfall triggering event" occurs (which may typically include a payment default on the first-out obligations, certain material events of default and/or the issuance of a notice to commence remedies), then all payments and proceeds of collateral received by the applicable agent will be applied pursuant to the "waterfall." The waterfall usually allows for payment of agents' fees and expenses and certain protective advances first (regardless of whether owing to a first-out or second-out lender), then pays the first-out obligations until paid in full and then the second-out obligations. The second-out lenders will typically require that such application to first-out obligations consisting of bank products and hedges be up to a capped amount or the amount reserved under the revolver for such obligations. The waterfall may also contain a cap on protective advances and an overall cap on the amount of the first-out obligations entitled to such priority. This type of provision would only be necessary if the AAL did not place limits on increases to the first-out obligations without consent of the second-out lenders.

A more recent development has been to have a "split-collateral" waterfall. Under this structure proceeds of accounts receivable, inventory or other current assets are applied to the first-out obligations until paid in full and then to the second-out obligations. Conversely, proceeds of fixed assets, or all other assets, are applied to the second-out obligations until paid in full and then to the first-out obligations.

Interest and Fee Split or "Skim." If the underlying facility has blended pricing then the AAL will set out which portion of the interest and fees is payable to the first-out lenders with the remaining portion going to the second-out lenders. The first-out lenders should be careful to make clear that only fees and interest actually received by the borrower would be distributed. Further, the first-out lenders would want to avoid allowing the second-out lenders to have such fees and interest charged to the revolver unless approved by the first-out lenders. Without that provision the second-out lenders can effectively turn second-out obligations into first-out obligations.

Voting. The voting sections are the most highly negotiated. The terms of the AAL will override whatever the credit agreement may provide as to the definition of required lenders and which lenders' consent is needed for amendments and waivers. The baseline agreement would be for all amendments and waivers to require the consent of a majority of the first-out lenders and a majority of the second-out lenders. More typical, though, is for the second-out lenders to have certain "drag-along" rights allowing them to approve amendments and waivers with the deemed consent of the first-out lenders so long as the borrower's financial performance is within certain thresholds and such amendments and waivers do not change any "sacred rights" required by the first-out lenders. These sacred rights will include any items in the credit agreement that require the consent of all lenders or all affected lenders. First-out lenders will also want to include: (i) any changes that affect how and when their loans are made, in particular, borrowing base calculations and reporting requirements if the first-out lender is an asset-based lender, (ii) waiver of financial reporting entirely or extension of delivery for more than a certain number of days, particularly if the first-out lenders are required to vote a certain way if the borrower's financial condition is within certain ratios and thresholds, (iii) any amendment or waiver that allows fundamental changes, such as a change of control, major acquisitions, major divestitures or major debt incurrences, (iv) changes to cash dominion or making any covenants "springing," and (v) if the first-out lenders are national banks or other regulated lenders, any provisions that such lenders are required to include in their credit agreements, such as provisions relating to compliance with anti-terrorism and anti-money laundering laws.

An important consideration for any first-out lender subject to "drag-along" voting under an AAL is whether or not the first-out lenders will be able to manage borrower requests and expectations. Since the borrower is not privy to the terms of the AAL and its voting restrictions, it may not expect the second-out lenders to be involved in negotiating changes to its borrowing base. This issue becomes particularly important if the first-out lenders have a prior relationship with the borrower, or a private equity group that owns the borrower. If so, the first-out lenders may want to negotiate for a drag-along of the second-out lenders on terms affecting revolving loan availability so long as such availability is not increased beyond a certain threshold.

Exercise of Remedies. If the facility goes into default, the AAL will delineate how and when remedies can be taken. One of the simplest exercises of remedies is the imposition of default interest. The AAL will typically provide that the first-out lenders can require that default interest be imposed on the first-out obligations and the second-out lenders can require that default interest be imposed on the second-out obligors. If the credit facility provides for delayed cash dominion, the first-out lenders will want to be sure that the AAL permits/requires that such dominion be exercised without being subject to the general rules on exercising remedies. This is because most AALs provide for a standstill on exercising remedies for a certain period of time (30-90 days) after a direction notice to do so is issued to the applicable agent. The first-out lenders will want their standstill period to be shorter than for the second-out lenders' and for their issuance to control if sent (similar to what the first-out lenders would have in a typical intercreditor agreement). It is important for the AAL to be clear on how remedies are taken once the applicable standstill period has run. Some AALs provide that the first notice to be acted upon allows the issuer of the notice the right to control the actions taken. Others require consent of both

sets of lenders for certain types of remedies.

Actions in a Bankruptcy. Despite the fact that voting provisions of AALs with respect to bankruptcy matters have not been tested in an actual bankruptcy, some AALs will contain provisions as to class voting, credit bidding, approval of debtor-in-possession financings (“DIPs”) provided by the first-out lenders under certain conditions, agreements not to provide priming DIPs, obtaining adequate protection, obtaining relief from stay and a statement that the AAL is a “subordination agreement” for purposes of the bankruptcy code. Given the lack of certainty on the validity of these provisions, some AALs are silent on these issues which effectively makes any action in a bankruptcy subject to the same voting provisions as govern the exercise of remedies. However, as noted above, the unitranche structure complicates matters in a bankruptcy and likely precludes (i) class voting without a bifurcation of claims and (ii) the ability to provide a “roll-up” DIP financing.

Buy-Out Right. The second-out lenders will usually have a buy-out right with respect to the first-out lenders that is structured similar to what one would see in an intercreditor agreement. The second-out lenders will want to include as a triggering event for such right any issuance of notice, or action taken, by the first-out lenders under the AAL that does not also require second-out lender consent. The first-out lenders will want the buy-out to apply to all of the first-out obligations, including the provision of cash collateral for bank products and hedges. More typically, the buy-out right will be structured so that bank products and hedges remain outstanding and secured under the loan documents. If that is the case, the first-out lenders will need to include a provision requiring that the provisions of the loan document relating to such obligations cannot be modified without consent of the first-out lenders.

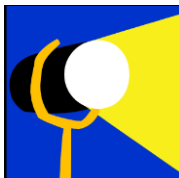
Right of First Refusal. One of the considerations for any lender entering into a unitranche facility is who they are getting in bed with, so to speak. Often, a lender may agree to provisions in an AAL for one lender that they may not be willing to agree to for any other lender. To protect against an undesirable lender coming into the facility, most AALs have a right of first offer that can be exercised based on any sale of the loans by a lender in the other class. It is important though, to exclude from the right of first offer sales to affiliates and related funds of the selling lender, sales to other lenders in the same class and sales made as part of a sale of all or a substantial portion of such lender’s loan portfolio. If there is going to be a syndication period after closing, those sales should also be excluded. If the right of first offer is exercised and lenders of one class end up holding loans of the other class, the parties will want to have provisions that govern voting those “cross-over” claims. Such provisions may provide that the “cross-over” claims cannot be voted at all or only as to items that require the consent under the credit agreement of all lenders or all affected lenders.

Agreements Among Lenders are not nearly as standardized as intercreditor agreements. Further, these agreements are constantly evolving based on the complexity of the underlying credit facility and the relationships among the parties. As such, the lawyers negotiating and drafting Agreements Among Lenders need to carefully parse the language of the agreement in conjunction with the provisions of the credit documents to ensure that the goals of their clients are met.

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UCC Spotlight

By [Stephen L. Sepinuck](#) and [Kristen Adams](#)



The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

Sunshine Heifers, LLC v. Moohaven Dairy, LLC, **[2014 WL 1509573](#) (E.D. Mich. 2014)**

This is a fairly simple case in which the court probably reached the correct result but its reasoning was flawed. The case also helps reveal something important about the phrasing and structure of Article 9.

The issue in the case was whether a postpetition lease of 240 cows to a dairy farm for 48 months was a true lease or a disguised sale. The court ruled that the transaction was a true lease because it did not qualify as a secured transaction under the rule of § 1-203(b). Specifically, even though the transaction was not terminable by the dairy farm, the dairy farm had no option or obligation to renew the lease or to buy the cows, and the term of the lease did not exceed the economic life of the cows because data indicates that more than 57% of cows produce milk for longer than four years.

Unfortunately, as explained in a [previous edition of this column](#), when subsection (b) of § 1-203 does not apply, that does not mean that the transaction is a lease; it merely means that the analysis falls back to the general, fact-specific standard of subsection (a). The court therefore erred in terminating the analysis, even if a complete review of the facts would not have changed the result.

It is interesting to note, however, that many courts have made this error. Let's consider why. The language of § 1-203(b) is that of a major premise in a syllogism: If P, then Q. As we all know, the converse of such a premise – If not P, then not Q – is not necessarily true. Thus, the subsection is merely a sort of safe harbor. It provides a definite answer when the condition (P) is satisfied, but no answer when the condition fails.

Article 9 contains quite a few of these safe harbors, *see, e.g.*, §§ 9-504, 9-611(e), 9-612(b), 9-613(1), (5), 9-614(3), 9-627(b), (c), most of which are expressly identified as safe harbors in the comments, *see* §§ 9-504 cmt. 2, 9-611 cmt. 4, 9-612 cmt. 3, 9-613 cmt. 3, 9-614 cmt. 3. *See also* § 9-627(d) (making clear that compliance with subsection (c) is not required). Unfortunately, the comments to § 1-203 do not expressly identify subsection (b) of that section as a safe harbor. In fact, they describe the relationship between subsections (b) and (c), but say nothing about the relationship of subsections (a) and (b). However, that silence in the comments does not alter the structure of the statutory text: subsection (a) is a general rule; subsection (b) is a specific rule for some, but not all cases. Thus, the inapplicability of subsection (b) does not provide an answer to the standard expressed in subsection (a). *See also* § 1-201(d) (containing another example of a sort of safe harbor: a nonexhaustive description – but not a definition – of what constitutes “nominal consideration”).

On the other hand, courts regularly – and properly – rely on the negative inference that can arise from a limited grant of permission. Consider a statement phrased as: If P, then you may Q. While the converse – If not P, then you may not Q – does not follow logically, it is nevertheless implied. Article 9 has several such rules. Perhaps the most obvious is the rule in § 9-609 that authorizes a secured party to repossess collateral without judicial process “if it proceeds without breach of the peace.” Courts universally understand this rule to mean that the secured party is in fact not authorized to proceed nonjudicially in a manner that does breach the peace. Other examples are contained in §§ 9-207(b)(4), 9-335(e), 9-603(a) and 9-604(c). *See also In re Brady*, [2014 WL 1330020](#), at *1 & n.12 (Bankr. E.D. Wash. 2014) (“the logical inference that can be drawn from 9-335 is that a tire merchant may not repossess accessions installed on an automobile if the automobile is subject to a secured claim of a creditor that is listed on the title”).

In essence, conditional rules of permission are best understood as implicitly containing the word “only”: Only if P, then you may Q. *Cf.* § 9-610(c)(2) (so phrased in describing when a secured party is authorized to buy the collateral at a private disposition). But in rules such as § 1-203(b) that do not grant permission, there is no negative implication and courts should not treat the converse as correct. When the conditions of subsection (b) are not satisfied, the analysis of the sale-lease issue is incomplete and must return to the basic standard of subsection (a).

Guaranty Bank & Trust Co. v. FGDI Division of Agrex, Inc.,
[2014 WL 1289466](#) (N.D. Miss. 2014)

This case about improper joinder of a party was decided based on the perceived right of grain buyers to take free of a security interest in the grain. Unfortunately, the court overlooked a critical phrase in § 9-320(a) and reached the wrong conclusion.

The facts are relatively straight forward. Guaranty Bank & Trust Company, a citizen of Mississippi, claimed to have a security interest in the grain of a farmer, David Walker. Walker sold the grain to Agrex, Inc., a citizen of Kansas, which in turn sold it to two grain terminals, one or both of which were apparently located in Mississippi. The bank brought a conversion action against Agrex and the two grain terminals in state court. Agrex removed the case to federal court, asserting that the citizenship of the grain terminals should be disregarded because the bank had no reasonable basis for a cause of action against them. The bank sought to have the case remanded.

In considering the bank's basis for joining the grain terminals, the court looked to § 9-320(a), which provides that a buyer in ordinary course of business, “other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.” Concluding that the grain terminals were buyers in ordinary course of business, the court readily concluded that the grain terminals took free and thus the bank had improperly joined them as defendants. The court's very brief analysis focused on the fact that the grain terminals had bought from Agrex, not from Walker, and thus had not bought from a person engaged in farming operations.

While the court might well have been correct that the grain terminals were buyers in ordinary course of business, it was clearly wrong in concluding that they took free of the bank's security interest under § 9-320(a). The very point that the court relied on to show that the grain terminals were protected by § 9-320(a) – that they purchased from Agrex, not Walker – in fact shows just the opposite. Section 9-320(a) allows a buyer to take free only of a security interest “created by the buyer's seller.” Agrex did not create the security interest, Walker did. The court completely ignored this important limitation in § 9-320(a), even though the situation presented in this case is akin to that in comment 3, example 1 to § 9-320, in which the buyer did not take free from a security interest established by the seller's seller.

It is possible that the court's conclusion about priority was correct for a different reason. Although § 9-320(a) does not protect buyers who purchase from a person engaged in farming operations, the federal Food Security Act does. *See* 7 U.S.C. § 1631; UCC § 9-320 cmt. 4. It is possible, therefore, that Agrex took free of the bank's security interest under that statute, which would mean that the grain was already unencumbered when sold to the grain terminals. However, Agrex did not make this argument and the court did not consider it.

Born v. Born,
320 P.3d 449 (Kan. Ct. App. 2014)

This is a case about strict foreclosure of a security interest and redemption rights in collateral. The secured creditor argued for a strict application of the UCC and although the secured creditor won, the court's application of the UCC was anything but strict.

The facts can be summarized as follows. After a series of intra-family transactions, Sharon Born acquired a security interest in the stock of H.J. Born Stone, Inc. ("Born Stone") and in Born Stone's membership interests in a LLC to secure a debt. The promissory notes provided that the death of Sharon's cousin, John, was an event of default. John died and his widow, Betty, contacted Sharon's attorney about making payment. Sharon refused, relying on a term in the security agreement that provided:

[Sharon] shall accept the Collateral by giving notice of such fact to Stockholder in which case [Sharon] shall forthwith take possession of the Collateral and all interest of Stockholder therein shall be forfeited and shall cease and terminate, and neither [Sharon] nor Stockholder shall have an[y] further liability to the other under this Agreement.

Betty sued seeking to enjoin Sharon from taking control of the stock and membership interests. The trial court ruled for Sharon and Betty appealed.

The appellate court affirmed. The court began by interpreting the security agreement as limiting Sharon to a single remedy: accepting the collateral in full satisfaction of the debt. Noting that the procedure for conducting an acceptance cannot be waived, *see* § 9-602(10), the court then examined the parties' conduct in reference to that procedure. First, the court concluded that Sharon had properly proposed to accept the collateral in satisfaction of the secured obligation even though her post-default letters to the debtor neither expressly stated that the debtor had the right to object nor indicated either the amount due or a means of calculating that amount. This ruling was correct. Nothing in § 9-620 requires that a proposal to accept collateral inform the debtor of the right to object or describe the secured obligation. Although, § 9-320 comment 4 indicates that a proposal "should specify the amount (or a means of calculating the amount . . .) of the secured obligations to be satisfied," the use of "should" rather than "shall" or "must" indicates that this is a permissive standard, not a requirement.

The court then dealt with whether the debtor had objected to the proposal. The trial court had ruled that, because the security agreement limited Sharon's remedy to acceptance of the collateral in satisfaction of the secured obligation, the only way that the debtor could properly object was if, in addition to expressing objection, it redeemed the collateral within a reasonable time. The appellate court apparently agreed. It then concluded that the debtor's tender of payment of some of the secured obligation and some of the collateral was not a proper tender. Hence, Sharon was now the owner of the collateral.

There are several problems with this analysis, but let's begin with what is right. To the extent that the clause in the security agreement could be interpreted as providing for Sharon to automatically become the owner of the collateral upon default, it would be unenforceable. Article 9 does not permit that. The secured party must either conduct a disposition or collection of the collateral, or propose an acceptance of the collateral in satisfaction of the secured obligation. These rules cannot be waived and the latter requires consent after default. *See* §§ 9-602, 9-620(a)(1). Although a few courts have, without much analysis, ruled to the contrary, *e.g.*, *Corsair Special Situations Fund, L.P. v. Engineered Framing Sys., Inc.*, [694 F. Supp. 2d 449](#) (D. Md. 2010) (because patent security agreement provided that the creditor's interest would "become an absolute assignment" after debtor defaulted, and debtor had defaulted, the security interest had become an absolute assignment of the patent), they are simply wrong. *Cf. In re Crossover Fin. I, LLC*, [477 B.R. 196](#) (Bankr. D. Colo. 2012) (clause in security agreement providing that, upon default, the debtor's rights as the sole member of limited liability company to vote and give consents, waiver or ratifications shall cease and that the secured party vote any or all of the pledged interest did not operate automatically; Colorado law requires a secured party to enforce the security agreement and become admitted as a member before the secured party may exercise voting rights associated with a membership interest pledged as collateral). Thus, the court correctly looked to whether Sharon had conducted a proper acceptance of the collateral.

To accept the collateral in full or partial satisfaction of the secured obligation, the debtor's post-default consent is required. A communication of objection negates consent. Nothing in the Code indicates, however, that the debtor must also redeem the collateral to make a proper objection. To the extent that the security agreement limited Sharon's rights upon default to accepting the collateral, it might have been a remarkably foolish provision (from Sharon's perspective), but is hardly a reason to interpret it as requiring redemption. Finally, and most important, the court's notion that redemption (by tendering full payment of the secured obligation) must occur within a reasonable time is simply not consistent with § 9-623. That section expressly states that the debtor has the

right to redeem until the secured party conducts a disposition, collection, or acceptance. § 9-623(c). Moreover, that rule too is not waivable. § 9-602(11). Thus, the debtor's right to redeem simply does not expire after a reasonable time passes.

In short, while the court may have been correct that the debtor failed to redeem the collateral by tendering less than all of the secured obligation, that failure did not terminate the debtor's *right* to redeem. Because a debtor is not required to redeem collateral to properly object to a proposal to accept the collateral, the court's conclusion that Sharon was now the owner of the collateral was wrong.

Tough Co., Inc. v. Wurlitzer,
2014 WL 298699 (Cal. Ct. App. 2014)

This case is about whether the seller of a truck, a trailer, and a bulldozer retained a security interest in all three items even though the buyer did not execute a security agreement and the bill of sale did not mention a security interest.

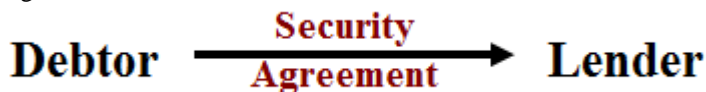
The court properly observed that all the documents relating to the transaction should be read together. Among these were the title documents for the truck and trailer, which identified the seller as a lienholder. The buyer conceded that those two items were encumbered but claimed there was no security interest in the bulldozer.

In concluding that there was, the court quoted language from § 9-203 comment 3: “a bill of sale, although absolute in form, may be shown in fact to have been given as security.” It then concluded that the bill of sale, coupled with the title documents for the other items and the seller's testimony, was sufficient.

The court's error was in its fundamental misunderstanding of the quoted language. Just as a deed of real property might be absolute on its face and yet in reality be given as security – by the grantor to the grantee – a bill of sale might appear to be an outright transfer – by the seller to the buyer – yet in fact be a transfer of less than all rights. That is, the buyer might really be a lender and the seller might be transferring title to property as collateral. In short, the comment acknowledges that a seller might be the debtor in a secured transaction, so that a transaction structured as follows:



is in economic reality the following:



In such a transaction, the bill of sale, which clearly transfers property rights to the buyer, actually transfers fewer rights than it purports to but it nevertheless has rights flowing in the same direction. *See also* § 9-203 cmt. 3 (“A debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security.”) The comment does not state or imply, as the court thought it did, that a bill of sale could cause a security interest to flow in the opposite direction. The court parroted the words of the comment without any understanding about what they mean.

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ENDNOTES:

- ¹ UCC Rev. § 1-301(b)(1) (2001) (withdrawn 2008) (emphasis added).
- ² UCC § 1-301(a) (2011) (emphasis added).
- ³ The Virgin Islands enacted the withdrawn version. V.I. Code Ann. tit. 11A, § 1-301.
- ⁴ Cal. Civ. Code § 1646.5.
- ⁵ N.Y. Gen. Oblig. Law § 5-1401.
- ⁶ 735 Ill. Comp. Stat. Ann. 105/5-5.
- ⁷ Fla. Stat. Ann. § 685.101
- ⁸ See N.Y. Gen. Oblig. Law § 5-1402; Committee on Foreign and Comparative Law of the Ass'n of the Bar of the City of New York, *Proposal for Mandatory Enforcement of Governing-Law Clauses and Related Clauses in Significant Commercial Agreements*, 38 Rec. A.B. City N.Y. 537, 548-49 (1983).
- ⁹ Ohio Rev. Code Ann. § 2307.39.
- ¹⁰ Del. Code Ann. tit. 6, § 2708(a).
- ¹¹ *Id.* § 2708(c).
- ¹² Tex. Bus. & Com. Code Ann. § 271.004(a).
- ¹³ *Id.* § 271.004(b)(1); cf. Restatement (Second) of Conflict of Laws § 188 (1971) (discussing factors).
- ¹⁴ *Id.* § 271.004(b)(2).
- ¹⁵ *Id.* § 271.005(a).

16 *Id.* § 271.006.
 17 *Id.* § 271.005(b).
 18 Restatement (Second) of Conflict of Laws § 187(2)(b) (1971).
 19 No. 95 CIV. 8136 (RCC), 1999 WL 178783 (S.D.N.Y. Mar. 31, 1999), *reconsideration denied*, 2000 WL 223838 (S.D.N.Y. Feb. 25, 2000).
 20 *Id.* at *2-3.
 21 2000 WL 223838, at *3 (citation omitted).
 22 *Cf.* UCC § 1-301 (not expressly mentioning the fundamental policy exception).
 23 Restatement (Second) of Conflict of Laws § 187(2)(b).
 24 This wording is similar in scope to the governing clause in the Loan Syndications and Trading Association’s Model Credit Agreement Provisions: “This Agreement and the other Loan Documents and any claims, controversy, dispute or cause of action (whether in contract or tort or otherwise) based upon, arising out of or relating to this Agreement or any other Loan Document (except, as to any other Loan Document, as expressly set forth therein) and the transactions contemplated hereby and thereby shall be governed by, and construed in accordance with, the law of the State of [New York].” *See* LSTA Model Credit Agreement Provisions, Section [Governing Law; Jurisdiction; Etc.](a) (August 1, 2012).
 25 *See* UCC § 1-301(a) (2001).
 26 *See* Restatement (Second) of Conflict of Laws § 187.
 27 *See also* Cal. Civ. Code § 1646.5; 735 Ill. Comp. Stat. Ann. 105/5-5; Fla. Stat. Ann. § 685.101; Ohio Rev. Code Ann. § 2307.39; Del. Code Ann. tit. 6, § 2708(a); Tex. Bus. & Com. Code Ann. § 271.004(a).
 28 N.Y. Gen. Oblig. Law § 1-1401 (emphasis added).
 29 *IRB-Brasil Resseguros, S.A. v. Inepar Invs., S.A.*, 20 N.Y.3d 310, 314 (2012).
 30 *See, e.g., DDR Real Estate Servs., Inc. vs. Bunham Pac. Props., Inc.*, 1 Misc. 3d 802, 807-808 (N.Y. Sup. Ct. 2003) (finding § 5-1402 of the New York General Obligations Law inapplicable to chosen-law clause specifying Maryland law); *ABAT vs. Chase Bank USA, N.A.*, 738 F. Supp. 2d 1093, 1095 (C.D. Cal. 2010).
 31 In that regard, one United States District Court sitting in New York, in upholding the application of § 5-1401 of the General Obligations Law suggested that there are constitutional limits to a court’s power to apply its own state’s law in a case that affects another U.S. state. *Lehman Bros. Comm. Corp. v. Minmetals Int’l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 135-138 (S.D.N.Y. 2000).
 32 *See, e.g., Tosaprat, LLC vs. Sunset Props., Inc.*, 86 A.D.3d 768, 770–771 (N.Y. App. Div. 2011); *Sun Forest Corp. v. Shvili*, 152 F. Supp. 2d 367, 388 (S.D.N.Y. 2001); *Supply & Bldg. Co. v. Estee Lauder Int’l, Inc.*, No. 95 civ. 8136 (Rcc) 2000 WL 223838, at *2-3 (S.D.N.Y. Feb. 25, 2000); *Union Elec. Co. v. Energy Ins. Mut. Ltd.*, No. 4:10-cv-1153 (CEJ), 2013 WL 5291701, at *2 (E.D. Mo. Sept. 19, 2013); *Sabella v. Scantek Med., Inc.*, No. 08 Civ. 453 (CM) (HBP), 2009 WL 3233703, at *13 (S.D.N.Y. Sept. 25, 2009).
 33 *Fin. One Pub. Co. Ltd. v. Lehman Bros. Special Fin. Inc.*, 414 F.3d 325, 334 (2d Cir. 2005); *Krock v. Kipsay*, 97 F.3d 640, 645 (2d Cir. 1996); *Rosenberg v. Pillsbury*, 718 F. Supp. 1146, 1150 (S.D.N.Y. 1989); *Innovative BioDefense, Inc. vs. VSP Techs., Inc.*, No. 12 Civ. 3710 (ER), 2013 WL 3389008, at *3 (S.D.N.Y. July 3, 2013); *Frazier Exton Dev., LP v. Kemper Envtl., Ltd.*, No. 03 Civ. 0637 (HB), 2004 WL 1752580, at *10 (S.D.N.Y. July 29, 2004).
 34 *See* cases cited *supra* note 33.
 35 *See* Troy Wolverton, *Feds: PayPal Not a Bank*, CNET, available at <http://news.cnet.com/2100-1017-858264.html> (last visited April 14, 2014).
 36 *See* UCC Rev. Art. 9, § 9-104.
 37 *See* UCC Rev. Art. 9, § 9-102(a)(29) (which defines a deposit account to mean “a demand, time, savings, passbook, or similar account maintained with a bank: [t]he term does not include investment property or accounts evidenced by an instrument”).
 38 *See* UCC Rev. Art. 9, § 9-102(a)(61) (which defines a payment intangible to mean “a general intangible under which the account debtor’s principal obligation is a monetary obligation”).
 39 Financial Crimes Enforcement Network Interpretive Guidance Memo FIN-2013G001 (Mar. 18, 2013), *available at* http://fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html.
 40 The UCP was first promulgated in 1933 by the Commission on Banking Technique and Practice of the International Chamber of Commerce and has gone through several revisions since then. Its latest revision became effective in July 2007 and was adopted as Publication No. 600 by the International Chamber of Commerce (UCP600).
 41 UCP600 Art. 1.
 42 *Compare* ISP98 Rule 3.14 *with* UCP600 Art. 36.
 43 *Compare* ISP98 Rule 4.06 *with* UCP600 Art. 14(c).
 44 *Compare* ISP98 Rule 3.08 *with* UCP600 Art. 32.
 45 An example is ISP98 Rule 3.09, which addresses a beneficiary’s demand to extend the expiration date of the standby or, alternatively, to pay the amount available under the standby, an issue that is uncommon in commercial letter of credit practice.
 46 It is not the intention of this article to single out specific agencies whose forms are problematic. However, each of the examples in this article is taken from an actual form standby letter of credit that is required by a governmental agency in the United States.
 47 In some circumstances, standby letters of credit are still being issued subject to UCP500, which was revised in 2007 and adopted as UCP600.

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- ⁴⁸ In one example, the letter of credit indicated that it was subject to the UCC. Revised Article 5 of the UCC has been adopted in some version by every state, but some states have varied its individual sections. As a further example of the type of problems a poor understanding of letter of credit law and practice might create, according to § 5-116(b) of Revised Article 5, the liability of the issuer of this letter of credit would be governed by the law of the jurisdiction in which the issuer is located. UCC Rev. Art. 5, § 5-116(b). That is, the issuer's liability may be governed by the law of a state other than the one who required the form.
- ⁴⁹ UCC Rev. Art. 5, § 5-102(10).
- ⁵⁰ UCC Rev. Art. 5, § 5-106(a).
- ⁵¹ A contrary rule did apply in UCP82 (adopted in 1933) through UCP500 (adopted in 1993) and, therefore, some letter of credit users expect to see the word "irrevocable" in a letter of credit. The use of the word "irrevocable" is clearly not as problematic as some of the examples that follow but still unnecessary.
- ⁵² See UCC Rev. Art. 5, § 5-103(d) (stating the independence principle); ISP98 Rules 1.06 (Nature of Standbys) & 1.07 (Independent of the Issuer-Beneficiary Relationship).
- ⁵³ ISP98 Rule 1.10.
- ⁵⁴ ISP98 Rule 1.10(a)(i)-(iii).
- ⁵⁵ ISP98 Rule 1.10(c)(ii).
- ⁵⁶ For a more detailed discussion of issues that arise in automatic extension clauses, see Thomas Volet, *Problematic Provisions in Standby Auto-Extension Clauses*, Documentary Credit World, Apr. 2014, at 24.
- ⁵⁷ A similar problem arises when the language of the letter of credit does not mention the state statute or regulation, but the beneficiary treats that statute or regulation as somehow affecting the issuer's obligations. In *Leary v. McDowell County National Bank*, 552 S.E.2d 420 (W. Va. 2001), the West Virginia Supreme Court of Appeals favored the policy underlying a state wage payment statute over letter of credit policy and essentially found that the letter of credit did not expire until the beneficiary agreed that it did. See also James G. Barnes & James E. Byrne, *Letters of Credit: 2001 Cases*, 57 Bus. Law. 1725, 1727 (2002).
- ⁵⁸ IIBLP is a not-for-profit educational and research organization that focuses its efforts on the harmonization of letter of credit law and practice. Among its projects, the IIBLP issued ISP98, and it has drafted Model Forms to be used in conjunction with ISP98. The forms are available without charge at www.iiblp.org.
- ⁵⁹ *First Fidelity Bank, Nat'l Ass'n, N.J. v. MidAtlantic Nat'l Bank (In re Ionosphere Clubs, Inc.)*, 134 B.R. 528 (Bankr. S.D.N.Y. 1991).