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## REPORT FROM COUNSEL

*FALL 2001 ISSUE*

### ***NEW REQUIREMENTS FOR SECURITY INTERESTS IN REVISED ARTICLE 9 OF THE UCC***

*By David R. Brown, Esquire and Patrick W. Carothers, Esquire*

On July 1, 2001, Revised Article 9 of the Uniform Commercial Code ("revised Article 9"), governing secured transactions became effective in Pennsylvania and in a majority of other states. A typical secured transaction involves a loan to a borrower, which the lender secures by taking a security interest in personal property of the borrower. Under the former Article 9, a lender perfected its security interest by either: (1) executing a security agreement with the Borrower and filing UCC-1 financing statements describing the collateral with the Secretary of State and at the court office in the county where the collateral was located, or (2) by taking possession or control of the collateral, depending on the type of collateral. Under revised Article 9, the information required in the security agreement and the financing statement has changed and the rules for perfecting certain types of collateral have changed. In addition, security interests may be taken in new types of collateral. The expansion of the Electronic Age has also been addressed by the authors of the revised Article 9.

#### ***Effect of Revised Article 9 on Previously Perfected Security Interests***

Security interests perfected under former Article 9 remain perfected for a period of five years if the lender properly perfected its security interest under former Article 9, and the changes in revised Article 9 which are unrelated to financing statements do not affect the previously perfected interest. However, if the rules unrelated to financing statements in

revised Article 9 do affect an existing perfected security interest then such secured party will have only one year from July 1, 2001 to conform its interest to the new rules. If the secured party complies within one year, it will retain its perfected status and whatever priority it previously enjoyed. If the secured party fails to take such steps, it will lose its perfected status and therefore any priority.

***a. Description of Collateral in Security Agreements***

While many existing security interests will not be affected, some property descriptions in security agreements have to be changed to preserve a lenders secured status. Revised Article 9 requires a more detailed description of the collateral taken as security than was previously allowed. The former Article 9 allowed the collateral to be described in a generic manner. A description such as, all property of the Debtor eligible to be given as Collateral under Article 9 of the Uniform Commercial Code was commonly used. Under revised Article 9, such a description will not be sufficient.

A description of the collateral must identify it in one of the following ways: (1) by a specific description; (2) by category, such as all Debtors computers at his business address; (3) by a type of Collateral defined by the Uniform Commercial Code, such as Equipment, Inventory or Accounts Receivable; or (4) by other method, if the identity of the collateral is objectively determinable. If the description used in a security agreement drafted under the former Article 9 is not amended to conform to the criteria required by revised Article 9, the lenders interest in the collateral will not remain perfected after July 1, 2002.

***b. New Categories of Collateral***

Although generic descriptions are no longer valid, some lenders will still desire a security interest in "all the debtors assets". For a lender to obtain such an interest under revised Article 9, a more specific description of the debtors assets will be required. If the lender decides to specify the debtor's assets by using the new Uniform Commercial Code categories, it must be aware that some categories of collateral are altogether new, some have narrowed and some have expanded in scope. Many goods which were formerly categorized as general intangibles now have their own defined category under the revised Article 9. Such category names should be used in the security agreement and financing statement in order to perfect a lender's interest.

The new categories of collateral consist of: deposit accounts, which includes all commercial (but not consumer) accounts maintained at banks, savings and loan associations, credit unions, trust companies or other banking institutions, including demand, time, savings and passbook accounts and certificates of deposit; electronic chattel paper; health-care insurance receivables; letter of credit payments; payment intangibles and imbedded software. A security interest may also be taken in commercial tort claims of the debtor. However, special attention must be taken to perfect such a security interest in the latter. The tort claim itself must be described in detail so as to clearly identify its nature and scope. While all assets require more specific definitions under revised Article 9, this standard is heightened when dealing with commercial tort claims.

Since deposit accounts and letters of credit are new types of collateral, it is important to note that an interest in these goods is perfected by taking control of the collateral. Control is taken by having the lender, the debtor and the bank involved agree in the form of an authenticated record that the bank will comply with instructions, originated by the lender, directing disposition of the funds in the account without the need of further consent by the debtor.

### ***Where to File UCC-1 Financing Statements***

Under revised Article 9, UCC-1 financing statements will be filed in one central location, as opposed to the former law which required filings to be made with both the State and the county where the collateral was located. UCC-1's will now be filed with the State where the debtor is located, which differs from the former law which required the filing to be made in the place where the collateral was located. If the debtor is a business, it is located in the jurisdiction where it is registered to do business. In Pennsylvania, all UCC-1 filings are to be made at the Office of the Secretary of State in Harrisburg. Local filings are no longer required. Please note that this change pertains directly to financing statements and therefore does not need to be changed for five years.

### ***Electronic Age Additions***

The electronic age has also brought about changes in revised Article 9. For the first time, UCC-1 financing statements may be filed in a paperless fashion, through an online system. If they are filed online, there is no requirement that the debtors signature be affixed to the UCC-1, provided the debtor has authorized the financing statement to be filed. However, proof of such authorization does not need to be attached to the actual filing. In addition to other means of authorization outside of Article 9, the debtors authorization in a security agreement will be sufficient to authorize the filing of a financing statement covering the same collateral listed in the security agreement. While a possibility of fraud exists under this system, it is really no greater than under the former law that required an actual signature. The likelihood of forgery existed under the former system which accepted filings without verifying the authenticity of the signature. The revised Article 9 does provide harsh penalties for a person who attempts to fraudulently file a UCC-1. The new law imposes a substantial monetary penalty along with criminal sanctions.

On the other hand, as the computer age has matured, the drafters of revised Article 9 have shown less tolerance for parties who commit human errors when filing a financing statement. Under the new rules it is vital that the information contained on the financing statement be accurate. The exact registered name of the debtor must be set forth properly on the financing statement. If the name is seriously misleading to the point that it cannot be located by a search of the UCC-1 records, such financing statement will be considered improperly filed and will not be effective. Therefore, a secured party must be certain it has ascertained the correct name of its debtor. It should include a provision in the underlying security agreement by which the debtor represents its true and correct name. Even by including such representation, however, a lender may not be protecting itself to the extent necessary. If the representation by the borrower proves to be incorrect, the lender could still lose its priority as to the collateral. By receiving the representation, the lender preserves its right to recover the value of the collateral from the debtor. However,

if the debtor has defaulted under the terms of the security agreement, a judgment against the debtor may be worthless. Therefore, great care should be taken to ascertain the correct name of the debtor so that the security interest is not lost.

### ***Conclusion***

The revised Article 9 may have a direct effect on existing security interests. While many of these interests will not be immediately affected by the change in law, it is still important to examine all pre July 1, 2001 filings as a proactive measure. The new law has afforded all secured parties at least a one year window to comply with any new rules, and in many cases five years. However, failure to review previously filed security interests in light of the changes could result in needless loss of a secured party's priority status.

Changes in definitions and manner of perfecting security interests will also require a revision to procedures and document language to assure compliance with the new rules.

### ***About the Authors***

*David R. Brown is a director of the firm. Mr. Brown's principal practice areas include business, corporate and commercial transactions, commercial financing, real estate transactions, beverage alcohol law, and probate proceedings. Mr. Brown earned a B.S. from the University of Pittsburgh in 1960 and his J.D. from Duquesne University in 1967. From 1978 to 1985, Mr. Brown was a lecturer on business organizations and real property law at Robert Morris College.*

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## ***EMPLOYMENT DISPUTE RESOLUTION: ALTERNATIVES TO LITIGATION***

*By Kathryn A. Sabatos, Esquire*

Multi-million dollar awards in employment litigation are becoming a common occurrence in our ever increasing litigious society. Employment-related claims are the largest category of federal civil lawsuits. At least 25,000 new federal job discrimination lawsuits are filed every year.

Not only are the numbers of filed suits increasing, but employees who bring employment lawsuits are increasingly victorious. In fact, jury verdict research suggests that the probability of a verdict favoring a plaintiff jumped from 49% in 1994 to 71% in 1999. The median compensatory award received by employees soared from \$127,500 in 1996

to \$200,000 in 1999. Due to the high costs and the increased number of very large jury damage verdicts, employers are being forced to settle these cases.

Because of the trend toward large jury damage verdicts and because the cost of employment litigation is continuously rising due to the increasing number of laws protecting employees, employers are realizing that there are more cost effective and beneficial ways to resolve employment disputes. Employment arbitration is proving to be a viable and successful alternative to litigation. Employment arbitration has grown rapidly in the past decade and surveys have shown as many as one in 12 U.S. workers is covered by an arbitration clause. Until recently, there have been questions about the ability to force unwilling workers to accept arbitration.

On March 21, 2001, in *Circuit City Stores, Inc. v. Saint Clair Adams*, No. 99-1379, the Supreme Court of the United States ruled that employers may compel workers to give up their right to sue over job bias complaints, forcing them instead to seek a remedy through private arbitration. In a 5-4 ruling, the court's conservative majority said that the Federal Arbitration Act of 1925 trumps an employee's right to sue under more recent workplace anti-discrimination laws. Now, all employers are free to require their workers to sign an agreement to arbitrate their disputes and may use these agreements to block workers from going to court.

Given this recent decision by the Supreme Court and since traditional ways of handling conflict no longer make good business sense, now is the time for employers to implement effective pre- and post-employment programs. Unfortunately, when most employers are faced with employment-related conflict, they tend to respond in one of two traditional ways, to either ignore it or if it escalates, then turn it over to the lawyers. A recent developing trend is for employers to implement in-house dispute resolution programs as a way to try to minimize and effectively resolve employment-related disputes that could lead to litigation.

There is no one correct formula for designing a dispute resolution program; therefore, while all programs should possess certain fundamental elements, the program should be sensitive to each organization's particular corporate culture. One such fundamental element is the inclusion of mediation as a precondition to arbitration. This can prove to be very beneficial to an organization because it enables an organization to attempt to resolve employment conflict first without engaging a third party decision-maker, thereby allowing it to save costs associated with litigation.

Furthermore, a successful in-house dispute resolution program is the result of dedication and commitment by the organization to making it effective. This includes having a very high level of continued training for the employees who will help administer the program and having the human resources department and the legal department work together in the drafting, implementation and administration of the program.

Finally, a successful program will be one that includes employee participation. A program will only be successful if the employees embrace it and utilize it. For example, if the dispute goes to arbitration, the arbitrator should be chosen by the mutual consent of both the employer and employee. The employer should also consider paying for all of the

initial costs of arbitration as a way of showing its commitment to providing a supportive work environment.

Implementation of an effective in-house dispute resolution program is only one element of an effective employment litigation management strategy. However, if drafted properly it can lead to a high performance workplace and may promulgate a corporate culture that embraces conflict prevention, conflict management and conflict resolution. The implementation will increase the morale of the employees, reduce turnover and as a result productivity will rise.

***About the Author***

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