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A GUIDE TO CURRENT PRACTICE

Guide to the Eagle 9™ UCC Insurance Program

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INTRODUCTION

This article provides an overview of The First American Corporation's *new EAGLE* 9" UCC Insurance Program for insurance of the attachment, perfection, and priority of security interests in personal property. In addition, the article contrasts this insurance program with legal opinions in commercial transactions and describes the use of the insurance program for insuring equity ownership.

The underlying premise of the *EAGLE 9*™ UCC Insurance Program is that there is a probability of economic loss to a lender in the event of a failure of lien priority as a result of inadequate review of preexisting tilings, incorrect filings, documentation errors, or similar factors.

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"One of the significant distinctions between the *EAGLE* 9'" UCC Insurance Program and real property title insurance is that the *EAGLE 9'"* program does not normally function as 'title' insurance?'

Although the probability of loss for a given lender in a specific transaction may be statistically small, the insured peril involved-the loss of lien priority--can have a significant adverse effect on the lender. A homeowner does not insure his or her home based on the probability of a fire occurring, but rather because of the significance of the loss if a fire does occur. Given the thin profit margins of lenders in today's competitive loan market, a loss of lien priority and the resulting reclassification of a lender from a secured creditor to an unsecured creditor in a bankruptcy proceeding could have a significant impact on the lender's net income. The *EAGLE* 9" UCC Insurance Program, like any casualty insurance product, substitutes a small certain expense (the premium) for a large uncertain loss; it transfers risk, protects against uncertainty, and generally reduces anxiety on the part of the lender.

SCOPE OF COVERAGE

One of the significant distinctions between the *EAGLE* 9" UCC Insurance Program and real property title insurance is that the *EAGLE 9"* program does not normally function as "title" insurance. Except for certain specific types of personal property that are the subject of civil title registries, such as motor vehicles, vessels, and aircraft, there is no procedure for a buyer or a lender to determine whether a seller of a television actually owns the television he or she is purporting to sell or use as collateral. Therefore, the first exclusion from coverage set forth at the beginning of the *EAGLE 9™* insurance policy is an exclusion for "The failure of the Insured Security Interest to Attach to any of the Collateral by reason of: (a) the Debtor not having Rights in the Collateral at or following the Date of Policy." This exclusion should come as little surprise to a commercial lawyer, because he or she understands that there is no effective title registration system for most types of personal property and that an insurer would be taking an unacceptable risk to guarantee that the borrower owns the television sets in the warehouse.

"The *EAGLE* 9" UCC Insurance Program does not replace necessary due diligence on the part of the buyer of personal property or the lender lending against the security of personal property to determine if the seller or borrower actually has ownership rights in the personal property."

Although the *EAGLE* 9 Insurance Program is not "title" insurance, the structure of the insurance product has certain similarities with land title insurance products, as the table on the following page illustrates.

<table>
<tr><th colspan="2">ALTA Real Estate Loan
Insurance Policy</th><th colspan="2">UCC EAGLE™
Insurance Policy</th></tr>
<tr><td>Exclusions reflect applicable law, including:</td><td colspan="2">Coverage</td><td>Exclusions reflect applicable law, including:</td></tr>
<tr>
<td>1. Matters created, suffered, assumed by the insured.

2. Matters known to the insured and not disclosed in writing to the insurance company.

3. A change in the law after date of policy.

4. Bankruptcy, insolvency, creditors' rights, fraudulent conveyance or transfer, preference, or equitable subordination, except as covered.

5. Failure to comply with applicable "doing business" laws.

6. Usury, truth-in-lending, and consumer protection laws.</td>
<td>1. Insures ownership of real estate.

2. Insures validity and enforceability of lender's lien (security interest (SI)) for loans secured by real property.

3. Insures against prior unknown liens (SIs) affecting the real property.

4. Coverage for loss due to forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation affecting the lien on the mortgage (SI) on real property.

5. Insures against failure of any assignment shown in Schedule A to transfer the insured mortgage on real property to the insured, free and clear.

6. Coverage for some challenges to insured mortgage lien (SI) brought in bankruptcy.

7. Provides for defense and indemnity.

6. Conditions and Stipulations: Similar to EAGLE 9™ Insurance Policy; coverage follows the ownership of the indebtedness.</td>
<td>1. Does not insure ownership of pledged assets.

2. Insures validity and enforceability of lender's SI (lien) for loans secured by personal property.

3. Insures against prior unknown SIs (liens) affecting the personal property.

4. Coverage for loss due to forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation affecting the insured SI (lien) in the personal property.

5. Insures against failure of any assignment shown in Schedule A to transfer the insured SI in personal property to the insured, free and clear.

6. Provides coverage for certain challenges to the insured SI in personal property brought in bankruptcy under appropriate rules.

7. Provides for defense and indemnity.

8. Conditions and Stipulations: Similar to ALTA Real Estate Loan Insurance Policy, but reflect applicable law; coverage follows the ownership of the indebtedness</td>
<td>1. Matters created, suffered, assumed by the insured

2. Matters known to the insured and not disclosed in writing to the insurance company

3. A change in the law after date of policy (this does not apply to the 2001 revisions to Article 9 of the UCC).

4. Bankruptcy, insolvency, creditors rights, fraudulent conveyance or transfer, preference, or equitable subordination, except as covered.

5. Failure to comply with applicable "doing business" laws.

6. Usury, truth-in-lending, and consumer protection laws.</td>
</tr>
</table>

The *EAGLE 9”* UCC Insurance Program does not replace necessary due diligence on the part of the buyer of personal property or the lender lending against the security of personal property to determine if the seller or borrower actually has ownership rights in the personal property. The *EAGLE 9™* UCC Insurance Program will not insure that a borrower securing a revolving line of credit with laptop computers in a warehouse actually owns the computers. The *EAGLE* 9’” UCC Insurance Program insures the attachment, perfection, and priority of security interests in personal property, not the ownership of or title to the personal property.

NOTE: As more fully discussed below, the one significant exception to the general principle that the EAGLE 9” UCC Insurance Program does not insure ownership is the insurance of ownership of equity in entities when the equity constitutes a “security” under Article 8 of the Uniform Commercial Code and the insured meets the requirements of a “protected purchaser” under Article 8.

“[T]he greatest malpractice exposure to a lender’s counsel is not in the negotiation and drafting of the primary loan documents . . . , but rather in the ordering and review of existing financing statements relating to personal property of the borrower.”

After realizing that there is no procedure for tracking ownership of personal property, the real estate attorney might ask: “Well, if this insurance product does not insure title, what does it do for me?’ The commercial finance lawyer, while not surprised that the *EAGLE 9™* UCC Insurance Program does not insure title to personal property, might react to personal property perfection and priority insurance by asking: “What does this product provide that is not already provided by the lawyers for the lender and borrower?’ Both questions and their responses are directed to the second aspect of real property title insurance-the insurance of lien position with respect to specified property. This is the significant utility of the *EAGLE* 9” UCC Insurance Program.

The starting point for discussing the *EAGLE 9™* UCC Insurance Program and the justification for this insurance product is to review what is and is not now customarily done by counsel for the lender and borrower in a secured personal property transaction, and what the *EAGLE 9’”* UCC Insurance Program provides to replace or improve on the tasks now performed by counsel.

MALPRACTICE EXPOSURE OF LENDER’S COUNSEL

First, consider the pricing of legal fees of lender’s counsel. It is typical in a secured personal property secured transaction for lender’s counsel to do at least two things: (1) examine the status of lien priority with respect to the pledged collateral of the borrower, and (2) prepare and file financing statements to perfect the lender’s lien in the assets of the borrower. In this context, consider how the pricing of legal services is usually determined. There is no correlation between the hourly rate of attorneys and paralegals and the risk of malpractice exposure to the law firm from the services being performed. Hourly rates are set through a combination of what the market will bear and what the partners want to make, and bills for legal services usually do not reflect the risks associated with the services being performed.

Review of UCC Search Results

In a commercial finance transaction, it is this author’s observation that the greatest malpractice exposure to a lender’s counsel is not in the negotiation and drafting of the primary loan documents (services requiring senior associate or partner attention), but rather in the ordering and review of existing financing statements relating to personal property of the borrower. The initial review of the LJCC search results is usually performed by paralegals, who are not as well trained as lawyers and whose billing rates typically provide the lowest rate of return to the law firm After his or her initial review of the UCC search results, the paralegal will often prepare a search summary chart listing the financing statements filed against the borrower by secured creditors and describing the collateral covered by the financing statements. These descriptions will typically note specific equipment of the borrower in the case of equipment lease filings or a blanket lien against all of the borrower’s assets filed by the borrower’s working capital lender. An attorney, usually a junior associate, will review the search summary chart but normally will not review underlying copies of the financing statements to avoid duplicating the service costs for the paralegal, unless the paralegal is uncertain as to the scope of a filing. For example, there might be unclear language associated with a purchase money security interest filing against specific equipment which may operate to encumber the borrower’s accounts or general intangibles that a working capital lender client would consider reliance collateral. As a consequence, the equipment riling should be unacceptable to the working capital lender, even though a filing against only the equipment and its proceeds would have been acceptable.

If a mistake is made by the paralegal, such as describing a filing as against specific equipment only when the filing actually encumbers additional collateral, a priming security interest may pass the review process undetected and unreleased. If the borrower defaults and a priority contest occurs in a bankruptcy court between the working capital lender and the equipment lessor, the lender's law firm could end up having to write a check to its client and perhaps lose the client over the mistake.

For example, consider a situation in which counsel representing a lender extending a revolving credit facility to a borrower reviewed the existing filings following the procedures described above. An equipment lessor had previously filed an informational filing against specific equipment and had included with the filing a copy of the master lease agreement. The master lease agreement was 28 pages of very small type and contained an imbedded grant of a security interest by the borrower in all of its assets to secure any shortfall in the borrower's obligations to the equipment lessor in the event of default. The paralegal designated the filing as against specific equipment only on the search review chart. There were a significant number of filings against the borrower, and the borrower was pressing the lender to close the transaction. Following standard procedures, the associate attorney reviewed only copies of the specific filings designated by the paralegal, and the imbedded senior blanket lien went unnoticed. Later on, the borrower filed bankruptcy. The value of the specific equipment was insufficient to repay the borrower's obligations to the equipment lessor due on default under the master equipment lease, and the working capital lender was primed by the equipment lessor. As a result, the working capital lender's law firm wrote a check to the lender in the amount of the payment from the estate to the equipment lessor in excess of the value of the equipment.

Preparation and Filing of Financing Statements

A lender's law firm incurs additional exposure, again at the least profitable billing point, in the preparation and filing of the lender-client's financing statements. Although attorneys usually assume that this function is not complicated and is without risk to the law firm, in reality, as with the review of filed financing statements, there is significant risk to the law firm in the event of a mistake, especially under Revised Article 9. For example, under Revised Article 9 the financing statement must use the exact registered name of the debtor, if there is one. An incorrect name makes the financing statement ineffective if the standard search logic of the relevant filing jurisdiction does not find it. This search logic standard for the accuracy of the name of the debtor is a more rigorous standard than the "seriously misleading" standard under former Article 9. Although, to many, the preparation and filing of a financing statement may seem to be a ministerial function, this is a mistaken belief. Most problems in the preparation and filing of financing statements are not publicized, because lawyers settle with their clients over loss of perfection or priority as a result of law firm error, rather than litigate the matter.

Not all errors have avoided the light of day, however. Following are examples of court cases concerning improperly filed or misfiled financing statements.

Incorrect Description of Debtor on Financing Statement

Armstrong v Dakota Bank & Trust (In re Knudson) (8th Cir 1991) 929 F2d 1280

A bank took a security interest in "all accounts" of the corporate debtor, "Goldie's Furniture, Inc." However, the security interest did not include the debtor's checking account, even though the checking account was in the name of the corporation. The owners of the debtor, the Knudsons, had signed all checking account documents and the loan agreement in their individual capacities rather than in their representative capacities. The depository bank was doing business with the Knudsons as individuals doing business under a trade name, rather than with the corporation. Therefore, the filing of the financing statement under "Goldie's Furniture Inc." did not provide inquiry notice to third parties of the depository bank's interest in the Knudsons' checking account, despite the fact the checking account was in the corporate name.

District of Columbia v Thomas Funding Corp. (DC App 1991) 593 A2d 1030

A financing statement that misspelled the name of the debtor "Silverline Co." as "Silvermine Co." was seriously misleading and rendered the financing statement ineffective. Therefore, lien creditors had priority over the unperfected interest of the secured party and the secured party was unable to collect $18,747 owed under service contracts.

First Nat'l Bank of Lacon v Strong (Ill App 3d 1996) 663 NE2d 432

A bank's financing statement that identified the corporate debtor by its trade name "Strong Oil Co." instead of its legal name of "E. Strong Oil Company" was seriously misleading. Because financing statements are indexed alphabetically, a diligent search of the records using the legal name would not have disclosed the financing statement. Therefore, the bank's security interest for $75,000 loaned to the corporation was unperfected and was junior to the claim of the State Department of Revenue as a lien creditor.

***ITT Commercial Fin. Corp. v Bunk of the West* (5th Cir 1999) 166 F3d 295**

A secured creditor's financing statement that identified the corporate debtor as "Compucentro, USA, Inc." instead of by its correct legal name of "Compu-Centro, USA, Inc." was seriously misleading. Because the subsequent creditor did not find the earlier filed financing statement when it searched under the legal name, the subsequent creditor had priority. The court noted that a subsequent creditor is not required to search under every conceivable misspelling of the debtor's name.

***In re La Selle's Bicycle World* (Bankr ND Okla 1990) 120 BR 579**

The first secured party filed a financing statement with the name "LASELLES, INCORPORATED" instead of its correct legal name "*La Selle's, Inc.*" When the second secured party conducted a search, the County Clerk advised that no financing statements were filed against the debtor under its correct name. The failure of the second secured party to give notice to the first secured party of its purchase money security interest as required under the Oklahoma statute was excused because the second secured party did not know about the first secured party's interest. The second secured party therefore had priority.

Failure **To File in Correct Location**

***GMAC v First Nat'l Bunk of Wayne (In re Ellingson Motors, Inc.)* (Bankr D Neb 1991) 139 BR 919**

The failure to file a continuation statement within six months of expiration of the original financing statement in the correct location was fatal to the perfection of the creditor's security interest. The original financing statement was correctly filed with the county clerk in 1977. The Nebraska statute was amended, effective September 1, 1981, to provide that all financing statements and continuation statements had to be filed with the Office of the Secretary of State in order to perfect a security interest. The original creditor, General Motors Acceptance Corporation (GMAC), filed the continuation statement with the county clerk within six months of the expiration of the original financing statement, but did not file a new financing statement with the Secretary of State as required under the revised statute. Therefore, the effectiveness of GMAC's security interest lapsed, and GMAC was unperfected. ***Even though the subsequent creditor was aware of the originalfinancing statement, the*** subsequent creditor was able to take advantage of the "technical" violation of the perfection rules and had priority over GMAC with respect to new car inventory.

***Franklin Nat1 Bank v Boser* (Tex App 1998) 972 SW2d 98**

A secured creditor perfected its security interest in cattle by filing its financing statement with the Secretary of State. The debtor thereafter acquired additional cattle and granted the seller a purchase money security interest (PMSI) in the additional cattle. The seller filed its financing statement with the County Clerk, rather than the Secretary of State. Although the holder of a PMSI normally has superpriority over other secured parties if the holder of a PMSI in equipment tiles its financing statement within 20 days of the debtor taking possession of the collateral, the failure to file in the correct location resulted in the seller being unperfected. Therefore, the creditor with the perfected security interest had priority over the seller's unperfected PMSI.

***In re Avalon Software, Inc.* (Bankr D Ariz 1997) 209 BR 517**

In this case, the secured party, Imperial Bank, failed to perfect its security interest in the debtor's copyrighted work because it failed to comply with both the Uniform Commercial Code and federal copyright law. The bank incorrectly thought that it needed to file a financing statement only with the Secretary of State to perfect its security interest and failed to file a notice with the U.S. Copyright Office. When Avalon declared bankruptcy, the bank was left with a debt of almost $1.5 million. To perfect a security interest in registered or unregistered copyright material, licenses, and proceeds attributable to registered or unregistered copyrighted material, a secured party must make the appropriate state filing and the filing with the U.S. Copyright Office. The bank's failure to comply with this requirement resulted in its being unsecured as to all copyright-related collateral.

Untimely Filing of Continuation Statements

***Jersey State Bunk v Isringhausen (In re Isringhausen)* (Bankr SD Ill 1993) 151 BR 203**

For a continuation statement to be effective, a creditor must file a continuation statement in the correct location within the six-month "window" period preceding the expiration of the original financing statement. In this case, because the bank filed its continuation statementfour ***days before the*** "window" opened, its continuation statement was not effective. Therefore, the perfection of the bank's security interest lapsed and the bank was unperfected.

***Banque Worms v Davis Constr.* Co. (Ky Ct App 1992) 831 SW2d 921**

A bank's continuation statement, which was filed six months and two days before expiration of the five-year period, was invalid to maintain perfection. Consequently, the bank's security interest in the debtor's truck was unperfected.

Change of Debtor's Chief Executive Office

***Schaheen v Allstate Fin. Corp.* (4th Cir 1992) 17 UCC Rep Serv 2d 1309**

When a debtor changes the location of its chief executive offtce, a secured party has four months in which to refile its financing statement in the new jurisdiction. In this case, the debtor moved its chief executive office from the District of Columbia to Maryland. The first secured party failed to refile in Maryland within the four-month grace period. The first secured party later tiled a new financing statement in Maryland. Therefore, the second creditor, who filed in Maryland just ***two days before*** the first secured party's late filing, had priority in the debtor's accounts.

***Mellon Bank, N.A. v Metro Communications, Inc.* (3d Cir 1991) 945 F2d 635**

When one corporation is acquired by another corporation in an acquisition or merger, the chief executive office of the acquired corporation does not necessarily become that of the parent corporation. A subsidiary's location of its chief executive office does not change unless it actually ceases to conduct business in the original offices and moves its offices to the parent corporation's state. In determining the location of a corporation's "chief executive office," the court looked to the place from which the debtor *manages* the *main part* of its business operations and where persons dealing with the debtor will normally look for credit information. In this case, the court found that the debtor conducted its primary business activity from its original location in Maryland for approximately eight months after its acquisition by a corporation that had its chief executive office in Pennsylvania. Although accounting and financial services of the debtor were consolidated with the parent corporation located in Pennsylvania shortly after the acquisition, the court noted that the location of such services was not determinative of the location of a subsidiary corporation's chief executive office. The bank's security interest did not become unperfected when it did not file in the parent corporation's state within four months after the acquisition. The bank properly filed in the parent corporation's jurisdiction within four months after the subsidiary debtor actually moved its chief executive office, eight months after the acquisition, and therefore its security interest remained perfected.

***Chase Manhattan Bank v Nemko (In re Nemko, Inc.)* (Bankr ED NY 1997) 209 BR 590**

In applying the analysis used in Mellon *Bank,* a court analyzed when the chief executive office of a debtor, Nemko, had moved from New Jersey to New York. The court concluded that the chief executive office had moved to New York by 1989 because the main part of the business was managed from New York and New York was the location where creditors would look to for information about Nemko. The court focused on the location of Nemko's principals and the majority of its key officers and employees. The court also looked at Nemko's concerted efforts to portray itself as a New York corporation as evidenced by its marketing literature, letterhead, trade publications, and business cards. Therefore, a New Jersey bank that failed to file a financing statement in New York within four months of the transfer of the chief executive office was unperfected, and a New York bank that filed its financing statement in New York had priority as to Nemko's account receivables.

Summary: Potential Malpractice Risk

From the perspective of the lender's counsel, the greatest area of potential malpractice exposure in representing the lender in a secured personal property transaction is the review of existing financing statement filings by other lenders against the borrower and the preparation and filing of the lender's financing statements. Neither of these activities are significant profit centers for a law firm. The profit potential in a loan transaction for lender's counsel is in the preparation and negotiation of the loan and security agreements, service areas that require mid-level and senior attorney attention and over which there is less malpractice exposure. When the borrower files bankruptcy, very seldom will there be a debate over the complex affirmative, negative, and financial covenants in the loan agreement that required hours of counsel time to negotiate and draft. The debate with the trustee or creditors' committee will be over the status of perfection of the lender's security interest. Given the expanded scope of Revised Article 9 and the additional categories of collateral now subject to encumbrance by an Article 9 security interest, coupled with the complexity of the transition rules and the increased probability of loss of perfection, challenges to the lien position of secured creditors should significantly increase under Revised Article 9, at least during the five-year transition period.

"The *EAGLE* 9" UCC Insurance Program is indemnity insurance, and as a result is broader in its coverage than a legal opinion."

In summary, with respect to the lien priority of the secured party in commercial finance transactions, lender's counsel has all the malpractice exposure for loss of first priority by the secured lender client, but is not adequately charging for the inherent risk, and typically is placing the greatest burden to control the risk on the least compensated and least prepared component of the legal delivery system.

LIMITATIONS OF PRIORITY OPINIONS

Over the years, except in specialized transactions such as mezzanine lending and securitization and with respect to certificated securities, competent counsel have refused to provide priority opinions. This is the result of a number of different factors. The first is the "Golden Rule." This rule, discussed in the ***Report Regarding Legal Opinions in Personal Property Transactions,*** by the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California, printed in 44 Bus Law 791-835 (May 1989) (hereinafter referred to as the "UCC Opinion Report"), provides that a lawyer should not request an opinion from another lawyer in circumstances where the requesting lawyer would not be willing to provide a similar opinion. Counsel to secured creditors will not provide priority opinions, and therefore they should not ask for such opinions.

The other principal factor in the demise of priority opinions in secured transactions is the inherent cost and complexity of a priority legal opinion. As stated in the UCC Opinion Report (44 Bus Law at 793):

> [C]ertain opinions (especially priority opinions) may be costly or cumbersome to give because of the extensive qualifications which must be drafted and the due diligence review which must be undertaken.

Even if lender's counsel can persuade borrower's counsel to provide a priority opinion, as stated in the UCC Opinion Report (44 Bus Law at 825):

> [T]he opinion may be significantly qualified as to the types of collateral and competing interests covered by the opinion. As a result, a well-drafted opinion will often contain qualifications and assumptions regarding so many items that the substantive meaning of the opinion is very slight or is incomprehensible to anyone who is not a specialist in personal property transactions. When an opinion becomes so qualified as not to be understandable to most readers, the motivating purpose of the opinion (i.e., to provide assurance to the secured party) is often lost. On the other hand, once the lawyer begins to list all the qualifications and assumptions to an opinion, the possibility of missing one or more possible issues is present. Consequently, priority opinions may be, on the one hand, uninformative because they tell the reader nothing or very little or, on the other hand, wrong or misleading because they fail to describe all exceptions. A secured party should weigh the difficulties and costs associated with the lawyer providing a broad priority opinion against the marginal benefits arising from such an opinion.

The UCC Opinion Report states that in order for a lawyer to provide a severely limited priority opinion confined to perfection by filing (44 Bus Law at 826 n 173):

> [T]he opining lawyer should, among other things, take the following actions: (i) confirm the legal name of the debtor . . ; (ii) confirm that the U.C.C. search request contains the proper spelling of the debtor's name. . . ; (iii) qualify the opinion for misindexed and misfiled financing statements. . ; (iv) search for any financing statements under similar names, partnerships of which the debtor is a member, and the name of a spouse, if any. . ; and (v) prefile the financing statement(s).

Thus, even if the lender and its counsel can force borrower's counsel to provide a legal opinion with respect to the attachment, perfection, and priority aspects of the secured transaction, the resulting opinion will be severely limited in its scope, because, as stated above, lawyers are risk adverse and are not being compensated to provide insurance coverage to the lender. The ***EAGLE 9™*** UCC Insurance Program is indemnity insurance, and as a result is broader in its coverage than a legal opinion, even if the lender could get one. The significant distinctions between ***EAGLE 9™*** and a legal opinion on priority of a security interest are as follows:

COMPARISON OF *EAGLE 9™* WITH TYPICAL LEGAL OPINION

COVERAGE	PRIORITY LEGAL OPINION	*EAGLE 9™* UCC INSURANCE POLICY
Negligence standard required	Yes	No
Indemnity protection	No	Yes
Recovery of attorney fees	No	Yes
Forgery and fraud	No	Yes
Collateral description	No	Yes
Correct states for filing financing statements	No	Yes
Secretary of State UCC search report accuracy	No	Yes
Priority based on filing of financing statement	Yes	Yes
Priority based on possession	No	Yes
Priority based on control of securities	Yes	Yes
Priority in proceeds	No	Maybe
Priority over judicial liens	No	Yes

Considering the limited scope of a borrower counsel's priority legal opinion (if one is available) and the risk aversion of counsel on both sides of a secured transaction, what the secured party really needs-assurance as to the priority of its security interest in the borrower's collateral-ends up resting primarily on the shoulders of lender counsel's paralegals. Further, the secured party's only remedy for loss of perfection or priority in the face of increasing challenges from bankruptcy trustees and creditors' committees is a malpractice lawsuit against the counsel who prepared the loan documentation and who is probably also representing the lender in the bankruptcy. This result is clearly untenable for the lender's counsel, and may also be unsatisfactory for the lender if counsel's malpractice coverage is inadequate or the issue is disputed in prolonged litigation.

There is currently a need for some form of security interest priority insurance, because the traditional methods of preparing and filing financing statements and perfecting the security interest of the secured party fail to provide adequate safety to the secured lender who uses personal property as loan collateral. The need is a corollary of the limited protection available from the lender's counsel. The *EAGLE* 9” UCC Insurance Program responds to this need.

Thus, the primary reason for the *EAGLE 9”* UCC Insurance Program is that there is nothing else available to give the secured lender the assurance it should be demanding concerning the perfection and priority of its security interest in its reliance collateral. This is not a cost replacement or cost justification approach, but rather reflects that the secured lender is not now getting what the it needs to be secure in its lien position.

EQUITY OWNERSHIP INSURANCE

As discussed above, the *EAGLE* 9” UCC Insurance Program by its terms generally does not cover ownership of collateral. The policy assumes that the borrower has rights in the collateral. Further, the *EAGLE 9™* UCC Insurance Program will not insure against a situation in which the insured lender perfects a security interest in stock or other investment property only by filing a financing statement and is subsequently primed by another lender perfecting in the same collateral through possession or control. If, however, the insured lender takes the steps required under UCC §8–303 to become a “protected purchaser” (that is, perfecting a security interest in a certificated or uncertificated security by control), the *EAGLE* 9’” UCC Insurance Program will, by endorsement to the standard form policy, remove the exclusion to coverage of the assumption that the borrower has rights in the collateral. With this endorsement, the *EAGLE 9™* UCC Insurance Program will effectively insure that a guarantor/pledgor (e.g., under a guaranty secured by an equity interest in a borrower) or a borrower/pledgor (e.g., providing equity in another entity as primary or secondary collateral) has title to or ownership of the pledged equity.

Multi-tiered debtor structures involving equity interests in entities (corporations, limited liability companies, limited partnerships, and general partnerships) as insured collateral (for example, a borrower with owner guarantors securing their guaranties with pledges of their ownership interests in the borrower) present ideal applications for this endorsement. If the lender wants to perfect in the equity interest through “control” so as to obtain a more protected priority position, the initial inquiry is whether the equity interest (common stock or preferred stock in a corporation, member interest in a limited liability company, partnership interest (general or limited) in a limited partnership, or a general partnership interest in a general partnership) is a “security” and therefore “investment property” for Article 9 purposes, or whether the equity interest is a “general intangible.”

If the equity interest is common stock or preferred stock in a corporation, the equity interest will qualify as a security under Article 8 (UCC §8–106), and as investment property under Article 9 (UCC §9–102(49)). As a result, there will be no need to take any further action to convert the status of the equity interest from a general intangible to investment property by opting in to Article 8.

If the equity interest is an ownership interest in a limited liability company (membership interest) or a partnership interest (general or limited) in a partnership (general or limited), however, one must inquire whether the entity has elected to have its ownership interests governed by UCC §8–103(c). If so, the equity interest is a security for Article 8 purposes. If not, the issuer of the equity interest in question must elect through appropriate entity action to have its equity interests governed by Article 8 of the UCC.

If the equity interests are securities by definition (stock in a corporation) or the issuer thereof has opted in to Article 8, the next question is whether the securities are certificated or uncertificated. This inquiry is necessary because the answer will determine the manner in which control of the securities can be maintained. “Control” of the securities by the lender is necessary for the lender to meet the requirements under Article 8 for “protected purchaser” status so as to be able to acquire the securities upon foreclosure free of adverse claims not known to the lender. Status as a protected purchaser is required for the issuance of the endorsement under the *EAGLE 9™* UCC Insurance Program to remove the assumption that the debtor has rights in the collateral.

If the securities are uncertificated, control is maintained through an agreement among the issuer of the securities, the lender, and the debtor.

If the securities are certificated, control is obtained by the lender by taking possession of the certificated securities and by obtaining a duly executed endorsement of the certificated securities from the borrower or other holder of record. The endorsement can be by executing an endorsement on the back of the certificated security, either in favor of the lender or in blank, or by a stock power or other endorsement separate from the certificate, again duly executed either in favor of the lender or in blank.

Given the above, the *EAGLE* 9” UCC Insurance Program can effectively insure the “ownership” of equity pledged by a debtor (whether a borrower or guarantor). In this context, the *EAGLE* 9” UCC Insurance Program moves from encumbrance-only insurance to true “title” insurance. Assuming that the lender does not have notice of any adverse claims, Fist American will insure over the risk of fraud, that the entity issuing the equity does not exist, or that the debtor does not hold any equity therein, because the lender has attained the status of a “protected purchaser” under Article 8 and will therefore cut off any adverse claims upon foreclosure.

CONCLUSION

In conclusion, the *EAGLE* 9”” UCC Insurance Program is the result of the same realization that occurred in the real property arena over 130 years ago—*i.e.*, that the right to sue one’s own lawyer in negligence is insufficient protection for a secured lender with respect to the perfection and priority of its security interest in the borrower’s personal property. Although the *EAGLE* 9™ UCC Insurance Program can be justified through reduced legal costs, both from counsel for the borrower and counsel for the lender, and from outsourcing certain financing statement preparation and tiling functions, the fundamental impetus for the product is that the *EAGLE* 9” LJCC Insurance Program provides indemnity insurance for perfection and priority of the lender’s security interest, and, in some cases involving a pledge of equity, can function as true title insurance. This coverage is not otherwise available to lenders, although a lender may be deceiving itself by thinking that the circular perfection opinion of borrower’s counsel and the malpractice coverage of its own counsel provide comparable protection to the lender. They do not, as was discovered in the real estate arena long ago.