Approved: April 25, 1996
Date

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY.

The meeting was called to order by Vice-Chairperson David Adkins at 3:30 p.m. on March 14, 1996 in Room 313-S of the Capitol.

All members were present except:
Britt Nichols - Absent
Mike O'Neal - Excused
Dee Yoh - Absent

Committee staff present: Jerry Donaldson, Legislative Research Department
Jill Wolters, Revisor of Statutes
Connie Burns, Committee Secretary

Conferees appearing before the committee:
Carla Stovall, Attorney General
Barkley Clark, Shook, Hardy & Bacon

Others attending: See attached list

Hearings on **SB 297** - Kansas consumer protection act, enhanced civil penalties when victims are elder or disabled persons, were opened.

Carla Stovall, Attorney General, appeared before the committee as a proponent of the bill. She explained that many elderly and disabled citizens are not able to read the fine print and do not believe that they would be lied to and therefore enter contests believing that they have a chance to win. Enhanced penalties for fraud on the elderly are not only appropriate but necessary to protect these citizens from unscrupulous operators. (Attachment 1)

Tom Young, AARP & Alice Hamilton Nida, Department of Aging, did not appear before the committee but requested that their written testimony be included in the minutes (Attachments 2 & 3)

Hearings on **SB 297** were closed.

Hearings on **HB 2525** - An act enacting revised article 8, investment securities of the uniform commercial code with conforming and miscellaneous amendments to articles 1,4,5,9 & 10, and **HB 3043** - Enacting revised article 5 of the uniform commercial code - letters of credit, were opened.

Barkley Clark, Shook, Hardy & Bacon, appeared before the committee as a proponent of the bill. He explained that both **HB 2525 & HB 3043** were technical in nature and these bills would simply modernize the commercial laws. He provided the committee with a summary sheet explaining New Article 8 of the Uniform Commercial Code (Attachment 4) and an article from Clarks' Secured Transactions Monthly explaining Article 5 (Attachment 5)

Hearings on **HB 2525 & HB 3043** were closed.

Representative Adkins made a motion to approve committee minutes from January 29, 30, 31 & February 5, 6, 7, 8 & 12. Representative Miller seconded the motion. The motion carried.

HB 3043 - Enacting revised article 5 of the uniform commercial code - letters of credit

Representative Miller made a motion to amend in the provisions of **HB 2525**. Representative Ruff seconded the motion. The motion carried.

Representative Miller made a motion to report **HB 3043** favorably for passage as amended. Representative Ruff seconded the motion. The motion carried.

SB 297 - Kansas consumer protection act, enhanced civil penalties when victims are elder or disabled persons

Representative Ott made a motion to report **SB 297** favorably for passage. Representative Standifer seconded the motion. The motion carried.

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY, Room 313 S Statehouse, at 3:30 p.m. on March 14, 1996.

Sub. SB 706 - Divorce decrees to include changes in beneficiary designations of insurance or annuity policies

Representative Standifer made a motion to amend the bill so it would include trust instruments and payment on death/transfer on death accounts. The motion was seconded. The motion carried.

Representative Standifer made a motion to report **Sub. SB 706** favorably for passage as amended. The motion was seconded. The motion carried.

The committee meeting adjourned at 5:00. The next meeting is scheduled for March 15, 1996.

HOUSE JUDICIARY COMMITTEE GUEST LIST

DATE: March 14, 1996

NAME	REPRESENTING
Bill Adams	Washburn Student
Susan Seltz	Attorney General
STEVE FARRICK	ATTORNEY GENERAL
Ken Smith	KS Bar Assoc
Barbara Clark	Attorney
Jim Clark	KCDAA
Jake Reisinger	KDOA
Robert Heinly	Washburn Univ.
Kathy Taylor	KBA
Danielle Noe	KCDAA
Nancy Lindberg	AG
Thomas E. Young	AARP
Vicki Arnott	SRS
THERESA SHIVELY	KJS
Jane Rogers	citizen
Mandy Patton	Washburn Student

State of Kansas
Office of the Attorney General
CONSUMER PROTECTION DIVISION
301 S.W. 10TH, LOWER LEVEL, TOPEKA 66612-1597
PHONE: (913) 296-3751 FAX: (913) 291-3699

CARLA J. STOVALL
ATTORNEY GENERAL

CONSUMER HOTLINE
1-800-432-2310

Testimony of
Attorney General Carla J. Stovall
Before the House Judiciary Committee
RE: Senate Bill 297
March 14, 1996

Chairperson O'Neal and Members of the Committee:

Thank you for the opportunity to appear before you today to testify in support of Senate Bill 297. This is a bill I requested that provides for enhanced penalties for those who prey on our elderly and disabled citizens. The bill provides an additional civil penalty of up to $10,000 for each violation of the Kansas Consumer Protection Act against an elderly or disabled consumer. The imposition of the penalty is not automatic, but is imposed by the court after considering specified factors set forth in section three of the bill.

This bill would address the alarming problem of fraud committed against our elderly and disabled citizens, who are often in a position where fraud is financially devastating. It is well known that unscrupulous telemarketing companies, door-to-door sales people, mail order companies, and other rip-off artists specifically target the elderly and disabled. I have attached an advertisement that illustrates this unscrupulous practice of targeting the elderly. This ad blatantly seeks buyers for a monthly list containing 75,000 names, stating, "**These people, mostly seniors, have invested in sweepstakes, lotteries, and other chances to win merchandise or cash prizes.**"

The Consumer Protection Division in my office has numerous heartbreaking cases of elderly Kansas citizens who were sold thousands of dollars in worthless items such as frisbees, pen sets, survival kits, water filtration units, vitamins, etc. In some instances, the elderly consumers had no need for these items, but were told they would win big prizes or cash if they would just send the money. In other cases, the elderly consumers were convinced by the unscrupulous telemarketer that their substantial purchase of items would help in the fight against drugs or some other worthy cause, when in fact the company had no intention of providing money to the worthy cause.

Many of the elderly consumers we hear from have been involved with more than two or three telemarketing transactions. All too often, substantial time has passed before we are contacted because these elderly consumers have spent so much of their life savings that some are ashamed to ask for help or to request refunds from the companies. Others sincerely believe they are going to win the enticing prize promised by the telemarketer or mail order company.

Many elderly consumers do not realize they do not have to make a purchase to be eligible for sweepstakes offers because they are unable to read the fine print or because the offer is carefully worded to suggest that making a purchase will increase their chances of winning the higher valued prizes. All too often our elderly citizens do not believe they would be lied to and therefore tend to believe what they are told by unscrupulous telemarketing companies, door-to-door sales people, and mail order companies.

Attached to my testimony is a table summarizing the plight of 15 elderly Kansas consumers whose complaints were handled by just one Consumer Protections Special Agent in 1992, 1993, and 1994. As you can see, these 15 elderly consumers had a total of 488 complaint files, demonstrating that unscrupulous businesses not only target the elderly, but go back to the proverbial well until it is bone dry. Because of this, I believe the enhanced penalties for fraud on the elderly are not only appropriate, but necessary to protect these valued citizens and put unscrupulous operators on notice that targeting the elderly for fraud in Kansas will not be tolerated.

Again, thank you for the opportunity to voice my support of this bill. I request your approval of the bill.

OFFICE OF ATTORNEY GENERAL
CARLA J. STOVALL

DATE	FILES	COUNTY	$ SAVED	$ LOST	CATEGORY
'93	48	Phillips	$83,971	$86,038	mail order/puzzle contests/telemarketing/ sweepstakes/prize solicitations
'93-94	96	Shawnee	$49,824	$95,197	telemarketing/mail order/sweepstakes
93-94	10	Sumner	$21,639	$27,234	telemarketing/mail order/sweepstakes
'93	24	Morris	$17,824	$25,578	puzzle contests/mail order/sweepstakes
'94	28	Smith	$24,263	$94,191	telemarketing
'94	41	Marion	$26,325	$54,756	mail order/charitable/telemarketing/ sweepstakes
'93-94	55	Pottaw.	$16,961	$21,656	mail order/puzzle contests/telemarketing
'94	15	Shawnee	$11,868	$48,685	telemarketing
'94	31	Wallace	$ 8,695	$11,222	mail order/charitable
'93	29	Pawnee	$10,522	$24,741	puzzle contests/mail order/telemarketing
'94	24	Shawnee	$ 7,988	$13,722	mail order/puzzle contests/charitable/ telemarketing
'94	7	Coffey	$ 8,647	$28,555	mail order/telemarketing
'92-94	10	Morris	$ 7,826	$27,797	telemarketing
'93	49	Morris	$ 5,284	$ 5,861	mail order/telemarketing
'93-94	21	Sheridan	$ 6,748	$11,092	mail order/charitable/telemarketing/ puzzle contests
Totals	**488**		**$308,385**	**$576,325**	

SB297Htst

Consumer

RESPONSE

00949—STALWART DEMOCRATS January 1989 to March 1991 contributors list contains 528,782 names at $60/M. These people support issues such as the extension of unemployment benefits, environmental benefits and middle-class tax relief. *Dependable Lists, Inc.—708/544-1000.*

00950—TITAN SPORTS ENTERTAINMENT CONGLOMERATE last 12-month buyers, subscribers and fan club members list contains 340,000 names at $70/M. These wrestling and bodybuilding fans have subscribed to publications on both sports and purchased related merchandise. *Total Media Concepts Inc.—201/692-0018.*

00951—HOUSE OF WHITE BIRCHES total product buyers list contains 277,913 names at $50/M. These people have purchased items including home and family products, dolls and collectibles and nostalgia products. *Direct Media Inc.—203/532-1000.*

00952—NEW ZEALAND PALANI FILE mail order buyers list contains 251,119 names at $135/M. These New Zealanders have purchased a variety of items, including cookware, watches, clock radios and sporting equipment. *The Broadmoore Group—1-619/324-3072.*

00953—RAZOR & TIE MUSIC last 12-month mail order buyers list contains 107,433 names at $55/M. These 1970s music enthusiasts are also members of the Preservation Society, dedicated to proving the '70s was the greatest decade of the 20th century. *ADCO List Management Services—212/779-3650.*

00954—FLORIDA COLLEGE CONTRIBUTORS AND SUPPORTERS list contains more than 92,000 names at $65/M. These sports fans support athletic teams and have contributed to other school-sponsored programs and fund-raising appeals. *Fred Woolf List Co., Inc.—914/694-4466.*

00955—ANATOMICAL CHART COMPANY 1991-1992 buyers and inquirers list contains 90,000 names at $90/M. These consumers are interested in health, medicine, nutrition, childbirth and science-related topics. *HR Direct—515/472-7188.*

00956—CENTURY SPORTS YEARBOOK merchandise buyers list contains 77,387 names at $70/M. These sports fans are interested in team information and sports-related merchandise. *Media Marketplace, Inc.—215/968-5020.*

00957—BIG BUCKS SUPER MULTIPUZZLE BUYERS monthly list contains 75,000 names at $75/M. These people, mostly seniors, have invested in sweepstakes, lotteries and other chances to win merchandise or cash prizes. *JAMI Marketing Services, Inc.—914/620-0700.*

00958—SECRET OPPORTUNITY SEEKERS last 12-month buyers list contains 50,000 names at $65/M. These people have purchased programs, manuals, franchises, make-money books and other success enhancers. *List Counsellors, Inc.—609/259-0600.*

00959—CARAMOOR CENTER FOR MUSIC AND THE ARTS ticket buyers, contributors and supporters list contains 35,921 names at $75/M. These upscale people, most from Connecticut, New York and New Jersey, enjoy classical, pop and jazz music. *Fred Woolf List Co., Inc—914/694-4466.*

00960—SPORTS CARD TRADER active subscribers list contains 20,883 names at $65/M. These sports card enthusiasts are interested in up-to-date prices and tips and the latest in sports memorabilia. *Media Marketplace, Inc.—215/968-5020.*

00961—KJL JEWELRY BUYERS last 12-month list contains 15,000 names at $80/M. These consumers, mostly women, have purchased pendants, bracelets, necklaces, earrings, rings and pins. *Direct Media—203/532-1000.*

COMPILED

00962—WEALTHIEST FAMILIES list contains 4.5 million names at $50/M. These individuals have high levels of discretionary income, hold diversified investment portfolios and enjoy luxurious lifestyles. *Dunhill International List Co., Inc.—305/974-7800.*

00963—ULTRA AFFLUENT DATABASE list contains 2,450,000 names at $50/M. These people include millionaires, conservative and liberal contributors; investors and professionals. *American List Counsel, Inc.—908/874-4300.*

INSERTS & CARD DECKS

00964—SYNCHRONAL insert program reaches 1.2 million annually at $55/M. These upscale buyers have purchased kitchen aids, beauty products and real estate opportunity offers. *Coolidge List Management—212/642-0310.*

00965—EARLY WINTERS, LTD. insert program reaches 118,400 annually at $60/M. These individuals are interested in clothing, equipment and other recreational-related accessories. *Millard Group Inc.—603/924-9262.*

00966—EVENFLO/BABY CONNECTION insert and sampling program reaches 1 million annually at $55/M. These women are new mothers. *The Abadi Group Inc.—908/531-7557.*

Business-to-Business

RESPONSE

00967—JANDEL SCIENTIFIC list contains 80,739 names at $100/M. These scientists and engineers purchase scientific-related microcomputer hardware, software and accessories. *Worldata—407/393-8200.*

00968—STUDIO ADVERTISING ART buyers list contains 20,836 names at $100/M. These small to mid-sized business owners and top managers develop business presentations, advertisements, brochures, etc. *Worldata—407/393-8200.*

00969—ESTRIN PUBLISHING PARALEGALS file contains 18,000 names at $125/M. These professionals, paralegals, attorneys and office managers, are interested in the latest books in the field. *PCS Mailing List Co.—1-800/532-LIST.*

00970—UNITED TRAINING MEDIA total file contains 15,830 names at $90/M. These training personnel and sales executives (top and mid-level) use video-based training and motivational products and services. *Data Card—301/680-3633.*

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2/14/96

SB297

THE RIGHTS OF OLDER PERSONS TO BE FREE FROM DISCRIMINATION, CRIME , AND ABUSE BY FAMILY AND INSTITUTIONS, ARE NO DIFFERENT FROM THOSE ENJOYED BY THE GENERAL POPULATION. HOWEVER, THE MANNER AND CONSEQUENCES OF INFRINGEMENT OF THESE RIGHTS ARE OFTEN FAR DIFFERENT FOR OLDER PERSONS, SOME OF WHOM MAY ALSO HAVE MORE LIMITED ABILITIES TO PROTECT THEMSELVES.

IT IS ONE THING TO FIND AT 35 YEARS OF AGE THAT AN INVESTMENT HAS GONE SOUR AND YOU HAVE LOST IT ALL. IT IS QUITE ANOTHER TO BE BILKED OUT OF YOUR LIFE SAVINGS AT AGE 70 OR 75. AT 35 YOU STAND A CHANCE OF REBUILDING THOSE SAVINGS AND INVESTMENTS BECAUSE OF THE OPPORTUNITY YOU HAVE TO WORK AND HAVE INCOME. AT AGE 70 YOU ARE LIVING ON SOME KIND OF RETIREMENT INCOME SUCH AS KPERS OR SOCIAL SECURITY AND YOU HAVE NO CHANCE TO BEGIN AND INVESTMENT AND SAVINGS PROGRAM. OFTEN THOSE SAVINGS WERE THE OLDER PERSONS HEDGE AGAINST INFLATION AND THE INCREASED COST OF LIVING.

THE NATIONAL AGING RESOURCE CENTER ON ELDER ABUSE FOUND THAT FINANCIAL EXPLOITATION ACCOUNTED FOR TWENTY PERCENT OF ALL ELDER ABUSE CASES.

[TOM SHOWED SOME EXAMPLES OF COME ON'S HE PERSONALLY HAD RECEIVED]

IT IS OUR FEELING THAT WHEN AN OLDER CITIZEN IS CHEATED OUT OF HIS OR HER LIFE SAVINGS IT HASTENS THE TIME WHEN THEY MUST GO INTO THE MEDICAID SYSTEM. AND RELY ON THE STATE & FEDERAL GOVERNMENT FOR SURVIVAL.

KANSAS NEEDS LEGISLATION WHICH WILL PROVIDE FOR STIFFER PENALTIES FOR THE EXPLOITATION OF OLDER KANSAS CITIZENS.

I ENCOURAGE YOU TO PASS SB 297

TOM YOUNG
CCTF COORDINATOR
AARP

House Judiciary
3-14-96
Attachment 2

TESTIMONY ON SB 297
by
Alice Hamilton Nida, Department on Aging
to the
House Judiciary Committee
March 14, 1996

The Kansas Department on Aging supports Senate Bill 297.

It is estimated that American consumers, especially the elderly, lose $100 billion dollars each year to consumer fraud.

Scam artists target older persons because they tend to be more polite toward strangers, more trusting, and have more free time. Older women living alone are particular targets for telemarketing.

Telephone solicitations appear to be the largest area of concern in Kansas. A common scenario is a friendly young voice that is so pleased to tell you that you've won a car. All you need to do is federal express (thus avoiding mail fraud) $50, $200 or $250 to them. And they will send you your new car. This is consumer fraud. You don't get a car. The scam artists gets your money. This is what consumer fraud is about--getting your money.

We at the Kansas Department on Aging provide information to older Kansans on how they can protect themselves. They can say no. They can hang up on teleracketeers. They can throw away those sweepstakes offers and puzzle contests.

You can also help slow down consumer fraud.

Enhanced penalties drive up the cost of doing business in Kansas. A private right of action and attorney fees allow Kansas' citizens to fight back.

We support SB 297 and urge you to pass it.

To: House Committee
From: Barkley Clark
Re: HB 2525 and HB 3043
Date: March 14, 1996

Attached are materials summarizing the content of both bills. In my opinion, both are worthy of passage; they are rather technical in nature and simply modernize the commercial law governing letters of credit and investment securities under the Uniform Commercial Code. They are both being rapidly enacted by other states as well.

House Judiciary
3-14-96
Attachment 4

A SUMMARY OF THE NEW ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

- New Article 8 is based on the fact that almost all publicly traded securities are still issued in certificated form, but held through securities intermediaries, largely clearing corporations, banks and brokers. In this "indirect holding system," the securities intermediary is the owner of record and changes in beneficial ownership are made by computer entries on the records of the intermediary; no certificates are ever actually transferred.

- Old Article 8 is based on the direct holding system in which ownership rights to the underlying security are represented by the certificate itself or, for uncertificated securities, by an entry on the issuer's records. The basic concepts are the notions of "possession" and the "transfer" of securities from one holder directly to another holder, and the basic relationship is between the beneficial owner and the issuer.

- New Article 8 retains the basic conceptual structure and rules of the present law with respect to the direct holding system, while providing a new framework designed for the indirect holding system. The idea is to remain flexible enough to accommodate whatever holding system the market may adopt in the upcoming decades.

- The Direct Holding System: Parts 2, 3 and 4 of the new Article 8 deal only with the rights of persons who hold securities directly from the issuer. Thus, those parts apply to the relationship between securities intermediaries and the issuer and between the issuer and those persons who still choose to hold directly their certificated securities or, as to uncertificated securities, are noted on the records of the issuer as the holder of record. Parts 2, 3 and 4 have no application to the rights of persons who hold securities through intermediaries; that relationship is governed by Part 5.

- Part 2, drawing on the principles of negotiable instruments law, provides the rules which prevent issuers from asserting defenses against subsequent purchasers who have no notice of adverse claims. Part 3 specifies the rules by which securities are transferred directly from one holder to another, again drawing from negotiable instruments law to protect the rights of purchasers against adverse claims. Part 4 specifies the mechanics by which the issuer or its transfer agent registers such transfers.

- The distinction in old Article 8 between certificated and uncertificated securities has been eliminated for most purposes. New Article 8 adopts a unified definition of

"security" which refers to the underlying intangible interest or obligation. The concepts of certificated versus uncertificated securities are retained only to distinguish different means of evidencing the ownership of the security.

- Indirect Holding System: The new rules governing the indirect holding system, set forth in Part 5, are built around the concept of "security entitlement." A "security entitlement" is the package of rights of a person who holds a security or other financial asset (such as money market instruments) through a securities intermediary. The rules in Part 5 describe that bundle of rights and the property interest that comprise a "security entitlement."

- A holder acquires a security entitlement when the intermediary credits the security or other financial asset to the account of the holder. The security entitlement is both a form of property interest, as well as an in personam right against the securities intermediary: The intermediary must maintain a sufficient quantity of financial assets to satisfy the claims of all of its holders. The financial assets so held are not subject to the claims of the intermediary's general creditors.

- Part 5 also includes a package of in personam rights against the securities intermediary, such as the duty of the intermediary to pass through to the entitlement holder the economic and legal rights of ownership of the security, including the right to receive dividends and other distributions and the right to exercise any voting rights. The intermediary also has a duty to comply with the authorized orders of the holder and, if so requested, to convert the holder's security entitlement into any other form of security holding available, such as delivering a certificate. As under the direct system, purchasers without notice are protected from adverse claims to a financial asset.

- The rules in Part 5 do not affect, and remain subject to, regulatory laws, such as the Federal securities laws. Also, the holder and intermediary may modify the rules by agreement.

- The economic result of holding a security entitlement through an intermediary or directly holding a certificated or uncertificated security should be the same; new Article 8 emphasizes that they are merely different ways of acquiring an interest in the underlying security.

New UCC Article 8 Ready for Enactment by the States; Changes Rules Governing Security Interests in Investment Securities

At its annual meeting in August, the National Conference of Commissioners on Uniform State Laws gave final approval to a new Article 8 of the UCC entitled "Investment Securities." The American Law Institute okayed the new statute earlier in the year. In addition to massive changes to Article 8, the revision also amends Article 9 to alter the rules governing security interests in investment securities. Since this is a vital type of collateral, these changes are of great significance to every secured lender. Each state will need to consider enactment within the next several years.

What is the background that led to new Article 8? How does it change the rules governing security interests in investment securities?

Background leading to reform. Article 8 was last amended in 1977, and virtually every state has now enacted those changes. The 1977 amendments were primarily intended to provide a legal framework for taking security interests in uncertificated securities.

Although the drafting of the 1977 amendments was a heroic effort, in recent years it has become apparent that this new legal framework was outdated almost before the ink dried. Serious problems have arisen. For one thing, it is confusing to have a system where some of the rules governing security interests in securities (such as how to perfect) are found in Article 8, while other rules (such as the duty of care and default procedures) remain in Article 9. By itself, § 8-313, setting forth the rules on perfection, is probably the most opaque provision in the entire UCC.

More important, the 1977 revision of Article 8 is wrong on several key assumptions. It assumes that changes in ownership (and the creation of security interests) are normally effected by sending instructions to the issuer instead of surrendering certificates. In fact, almost all publicly traded nongovernmental securities are still issued in *certificated* form and are held by clearing corporations. Any change in ownership, or the creation of a security interest, occurs by notation on the records of the clearing corporation and other financial intermediaries. In fact, the Depository Trust Company (DTC) has possession of most of these certificated securities and is the shareholder of record. Transactions involving these securities are handled through the records of broker-dealers and banks that serve as financial intermediaries in a multi-tiered pyramid extending from the issuer, to DTC, to other financial intermediaries, and ultimately to the beneficial owner.

Although Treasury securities are uncertificated, the trading and holding system is similar to that for publicly traded private securities, with the Federal Reserve Bank of New York acting as the tier next to the apex of a pyramid, which broadens out to member banks that serve as custodians for Treasury securities dealers, large investors, and smaller banks that in turn act as custodians for investors. Neither Treasury itself nor the Federal Reserve Bank of New York show the

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- Court Strikes Bank Seeking Equity Stake in Foreclosure Sale 5
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- Disappointed Buyer of Defective Goods Has Statutory Lien to Secure Return of Price 7

Prepared by
Barkley Clark
Shook, Hardy & Bacon P.C.
Kansas City, Missouri

Barbara Clark
Commercial Law Institute
Kansas City, Missouri

interest of the beneficial owner on their records; they only show the next tier of financial intermediaries. The 1977 amendments to Article 8 were not drawn with this "pyramid model" of financial intermediaries in mind.

Financial intermediaries and securities accounts. Moreover, the 1977 revision of Article 8 does not fully recognize the fact that investment securities are often held today by financial intermediaries in management accounts that are constantly turning over, like inventory or receivables. Under this holding system, it makes more sense to treat a security interest in investment securities as a security interest in an *account*, with the financial intermediary serving as account debtor. The norm is now a "floating lien" covering a constantly shifting mass of investment securities.

For good discussions of the uneasy fit of the current law with modern securities holding and transfer systems, see Mooney, "Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries," 12 Cardozo L. Rev. 305 (1990); Schroeder & Carlson, "Security Interests Under Article 8 of the Uniform Commercial Code," 12 Cardozo L. Rev. 557 (1990).

The new rules in a nutshell. It was against this background that the Commissioners on Uniform State Laws drafted the 1994 revision to Articles 8 and 9. This revision relocates all the rules governing security interests in investment securities to Article 9, particularly new § 9-115, eliminating the uncomfortable bifurcation that presently exists between Articles 8 and 9. In addition, the revision makes the following changes:

- It defines the rights and benefits enjoyed by a customer of a financial intermediary as a new type of collateral—a "securities account" or a "commodities account." These names more accurately reflect the indirect holding system that dominates the landscape today. This concept sets the stage for treating security interests more like floating liens on accounts receivable.
- Unless the secured lender is registered as the owner of the securities account, the financial intermediary is obligated to pass through to the borrower the right to vote, as well as the right to receive dividends and distributions. The financial intermediary is obligated to follow authorized account orders originated by the account holder.
- If the financial intermediary becomes insolvent, the securities held for customers are not general assets of the financial intermediary subject to the claim of the owner (and secured party) as general unsecured creditors; instead, they are assets of the customer. This rule departs in one important respect from the pure "accounts receivable" model.
- The revision abandons the "transfer" concept presently found in § 8-313 and allows a security interest in securities to be created under § 9-203, just as with any other type of collateral. This change brings security interests in investment securities back to where they were before the 1977 amendments. The term "investment property" is introduced, encompassing both individual securities and "security entitlements." Corresponding changes are made to exclude investment property from the categories of "instruments" and "general intangibles."
- Attachment of a security interest in investment property, such as securities, security entitlements, securities accounts, commodity contracts, and commodity accounts, requires a written security agreement. However, as under current law, no written security agreement would be required for attachment when the secured party had possession of certificated securities. The concepts of "attachment" and "perfection" both come back into play under Article 9, as with other types of collateral. Attachment and perfection of a security interest in a securities account also covers all securities and other entitlements in that account.
- Obtaining control over the investment property is one of two ways to perfect a security interest. "Control" means that the secured party has taken the necessary steps to allow it to sell the securities at foreclosure without further acts by the debtor. Taking possession of certificated securities, with proper indorsement or stock power, is one obvious method of gaining "control." The other method is by agreement of the financial intermediary to comply with the secured party's orders without further consent of the debtor.
- A security interest can also be perfected by *filing a UCC financing statement*, even with respect to certificated securities. This is a revolutionary idea. However, a secured party who relies on filing will not necessarily assure itself of priority over other secured parties or outright purchasers of the collateral. Perfection by filing primarily protects the secured lender against the borrower's trustee in bankruptcy.
- If the financial intermediary is the secured party, perfection is *automatic*. This rule includes margin loans from a broker to its customer. If a broker is the debtor, a security interest is also automatically perfected.
- Under current law, a security interest in investment securities can be perfected by simply notifying the finan-

4-5

cial intermediary as a "bailee with notice." (§ 8-313(1)(h).) This approach will not work under the 1994 revision. The secured lender must get "control" over the securities by agreement from the financial intermediary, or file a UCC-1.

- A secured party who perfects by gaining "control" over the securities has priority over a secured party who perfects by filing. In addition, a security interest in a securities account granted by the account holder to its financial intermediary has priority over any competing security interests; this is a variation of the priority-by-control theme.
- If more than one secured party has "control," the security interests rank equally. If more than one secured party has filed, the first-to-file rule of § 9-312(5) governs. Purchase money security interests are *not* allowed for investment securities.
- In recognition of the parallel between using a securities account as collateral and using inventory or accounts receivable, *generic descriptions* are allowed in both the security agreement and any financing statement. For example, a description of investment property as collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category or quantity, by a computational or allocational formula or procedure, or by any other method, if the identity of the collateral is objectively determinable.
- Duties of care for a pledgee of certificated securities and default procedures would be governed by the general rules of Article 9.

Bottom line. Under the 1994 revision, security interests in certificated securities will continue to be perfected in most cases by possession. If the collateral is uncertificated securities, or other types of "security entitlements," or securities accounts, security interests will be perfected by "control" (i.e., agreement with the financial intermediary) or UCC filing.

Perfecting security interests in investment securities has been a continuing headache for secured lenders around the country. The current version of Article 8 is very confusing on this score. It is also outdated. Thus, the 1994 revision of Articles 8 and 9 is a welcome reform.

Bending to Recent Court Decisions, FCC Liberalizes Policy on Security Interests in Broadcast Licenses

In the last few years, one of the hottest topics in secured lending has been the validity of security interests in broadcast licenses in light of the FCC's long-standing "anti-assignment" policy. Of late, the pendulum has been swinging in favor of the secured lender. In response, the FCC decided to review its policy. Now comes a decision by the chief of the FCC Mobile Services Division that recognizes the validity of security interests in the proceeds of an FCC broadcast license assigned to an FCC-approved third party as part of a Chapter 11 plan. This is good news for secured lenders who finance the communications industry. It also may be an important precedent for other types of secured lending.

The conflicting case law. Lenders who finance a broadcast licensee generally retain a security interest in both the "hard assets" (i.e., equipment and any real estate) and the most valuable intangible asset—the FCC license. However, in order to protect the airwaves from unauthorized intrusion, the FCC has a longstanding policy against a licensee giving a security interest in a license. The leading case is *In re Merkley*, 94 FCC2d 829 (1983).

In light of this strong FCC anti-assignment policy, a number of courts in bankruptcy cases have held that a security interest can't attach to an FCC license, and therefore can't attach to the proceeds of assignment of the license to an FCC-approved third party as part of a Chapter 11 reorganization. (See, e.g., *In re Tak Communications*, 985 F2d 916 (7th Cir. 1993).) These holdings deprive the secured lender of its most valuable collateral.

Other courts have been more generous. In *In re Ridgley*, 139 BR 374 (Bankr. D. Md. 1992), the court drew a distinction between a security interest in the license itself and a security interest in the proceeds of assignment to an FCC-approved third party. The court could see no reason why the latter would violate the FCC policy against unauthorized intrusion of the airwaves.

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Revised UCC Article 5 Fine-Tunes Letter Of Credit Law

Article 5 of the UCC, which sets forth the legal framework for letters of credit, has been fully revised. The revision has now been approved by the two sponsoring groups, the American Law Institute and the Commissioners on Uniform State Laws. It is now ready for introduction into the various state legislatures. We expect a number of adoptions in 1996.

Since Article 5 was first drafted 40 years ago, letters of credit—both commercial and standby—have blossomed around the country and throughout the world. Standby letters of credit now total nearly $500 billion on an annual basis worldwide, of which $250 billion are issued in the U.S. Standby letters secure every imaginable obligation. Commercial letters are a key tool in international trade. Litigation on various letter of credit issues is epidemic throughout the world.

Because letters of credit (particularly standby letters) may be viewed as a form of collateral supporting the applicant's duty to pay the beneficiary, it seems appropriate to review in this newsletter the key changes brought about by the revision of Article 5. What follows is our laundry list of key changes.

Independence principle. Perhaps the most important rule for letters of credit is that the letter must be kept independent of the underlying obligation which gives rise to it. The issuer of a letter of credit is not a guarantor, with power to raise defenses based on the underlying contract. If the issuing bank based its decision to honor on the underlying contract rather than the documents presented at the time of the draw, the commercial utility of the letter of credit would be completely undermined. With this policy in mind, the drafters of revised Article 5 have incorporated several strong statements of the independence principle. (See Rev. UCC §§5-103(d) and 5-108(f).)

Fraud and forgery. Easily the biggest "loophole" in the independence principle is the legal right of the issuing bank to refuse payment (and the applicant's right to get an injunction) based on the applicant's allegations of forgery in the documents or fraud in the underlying transaction. No issue has been so heavily litigated under current Article 5. (See UCC §5-114.)

In another bow to the independence principle, the revision makes it somewhat tougher for the applicant to get an injunction against the bank's honor of draws under a letter of credit. (Rev. UCC §5-109.) To get injunctive relief, the applicant must show not just "fraud," but "material fraud." Second, the fraud must be by the beneficiary, not some other party. Third, the normal limits on equitable relief apply, such as no injunction if the applicant has an adequate damage remedy against the beneficiary. Fourth, anyone seeking an injunction must post a bond or provide "other adequate protection" to the bank and the beneficiary for injury they may suffer as a result of an injunction.

In its stinginess toward injunctions, the revision moves closer to the model of California, which has deleted any reference in Article 5 to injunctive relief. On the other hand, the revision still makes it possible for the applicant to get an injunction based on proof of "material fraud" in the underlying transaction—a continuing exception to the indepen-

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dence principle. So long as it acts in good faith, the issuer of the letter may either honor or dishonor drafts upon receiving an allegation of fraud; if it chooses to honor the draft, the burden is shifted to the applicant to get an injunction.

Strict compliance. Another key issue in letter of credit law is whether the proper standard governing review of documents is "strict" or "substantial" compliance. The current version of Article 5 is vague. Rev. UCC §5-108 requires that presentations "strictly" comply with the terms of the letter. Otherwise, the issuer honors draws at its own risk, unless the applicant waives the discrepancies. In fact, strict compliance is the general industry standard. Under Rev. UCC §5-108, the issuer is required to observe "standard practice of financial institutions that regularly issue letters of credit." Would a reasonable document-checker at a bank find strict compliance? That's the new standard.

On the other hand, the term "strict compliance" does not mean "mirror image." It does not require slavish conformity to the terms of the letter or "oppressive perfectionism." In short, there is a de minimus rule here. The Comment to Rev. UCC §5-108 approves of cases like *Tosco Corp. v. FDIC*, 723 F2d 1242 (6th Cir. 1983), where the letter called for "drafts Drawn under Bank of Clarksville, Letter of Credit Number 105" while the draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court found strict compliance despite the change of upper-case "L" to lower-case "l", despite use of the word "No." instead of "Number", and despite addition of the city and state where the bank was located. As another example, mere typos would still "strictly" comply. Still, the line between "oppressive perfectionism" and "strict compliance" will continue to be the subject of litigation. Wherever possible, the issuer will seek waivers from the applicant.

Time for honor. Current UCC §5-112 requires the issuer to honor or dishonor a draw within three days after receipt of the documents. Rev. UCC §5-108(b) repeals the three-day rule and replaces it with a "reasonable time but not beyond the seventh business day." This new, somewhat more flexible standard generally conforms with the Uniform Customs and Practices (UCP) of the International Chamber of Commerce. The seven-day period is *not* a safe harbor. The time within which the issuer must give notice of dishonor will often be less than seven days, particularly when the letter is a standby with little documentation. Determining what is a "reasonable" time for examination of documents depends on what other banks do. This should encourage the use of expert witnesses in letter of credit litigation.

Rev. UCC §5-108(b) makes it clear that the issuer can't simply sit on a presentation made within seven days of expiration. On the other hand, a beneficiary who presents documents shortly before the letter's expiry date runs the risk that it will not have an opportunity to cure any defect.

Notice of dishonor. Under the current UCC, the issuer has no duty to give notice of dishonor to the beneficiary so that the beneficiary can cure the documentary glitch. The courts have filled this gap by importing doctrines of "estoppel" and "waiver" to protect the beneficiary in these cases. The revision provides that the issuer is "precluded" from raising any documentary discrepancy if timely notice of dishonor is not given. (Rev. UCC §5-108(c).) Moreover, notice must include a full bill of particulars, not just one of several discrepancies. Finally, failure to give timely notice of dishonor precludes the issuer from raising the documentary discrepancy as a basis for dishonor, even if the beneficiary is not injured by the failure to give notice. By this rule, the drafters of the revision have struck a balance: the issuer is protected by the "strict compliance" standard, while the beneficiary is protected by the "preclusion" rule.

Electronic letters. The current version of Article 5, drafted 40 years ago, assumes paper-based letters of credit. More and more, however, letters are being transmitted from issuer to beneficiary electronically. Rev. UCC §5-104 encourages this practice by authorizing issuance or confirmation of a letter of credit "in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties..." In turn, Rev. UCC §5-102(a)(14) defines "record" as "information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and that is retrievable in perceivable form." No traditional writing is required in the issuance of a letter of credit. There are parallel developments for "electronic contracts" in the current revisions to Article 2, for "electronic securities" under revised Article 8, and "electronic filing" in the current revisions to Article 9. It is, indeed, the age of electrons.

On the other hand, the revision to Article 5 does *not* authorize electronic *presentation of documents* unless the parties agree among themselves to jettison the written medium. (Rev. UCC §5-102(a)(6).)

Incorporating standard industry practices and the UCP. Just as revised Article 5 recognizes modern technology in its authorization of electronic letters of credit, so does it seek to incorporate changing industry practices. For example, Rev.

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UCC §5-108(e) directs issuers to "observe standard practice of financial institutions that regularly issue letters of credit." As another example, Article 5 continues to bow to the UCP whenever there is a conflict between the two and the parties have incorporated the UCP into their letter of credit. (Rev. UCC §5-103(c).) The UCP is treated as a contractual modification of the rules of Article 5. In this way, Article 5 will continue to change with new drafts of the UCP. (See also Rev. UCC §5-116(c).) Moreover, revised Article 5 contains a number of new rules that conform better with the UCP, such as the seven-day rule for examining documents and the rule that letters are irrevocable unless stated otherwise.

Subrogation. In the last few years, we have seen an outburst of litigation regarding the right of an issuer who has paid on a letter of credit to jump into the shoes of a secured beneficiary and thereby defeat the applicant's trustee in bankruptcy. Without subrogation, the issuer would be only an unsecured creditor seeking reimbursement. The current UCC is silent on the issue and the courts are split. Some courts prohibit subrogation on the ground that the issuer of a letter of credit is not a "true guarantor" and only "true guarantors" get subrogated to the rights of the parties they pay off. (See, e.g., *In re Economic Enterprises, Inc.*, 44 BR 230, 40 UCC Rep. 478 (Bankr. D. Conn. 1984)(in disallowing subrogation, court relies on independence principle).) Other courts allow subrogation by an unpaid issuer. (See, e.g., *In re Valley Vue Joint Venture*, 123 BR 199, 13 UCC Rep.2d 841 (Bankr. ED Va. 1991)(subrogation is equitable principle that should be applied broadly rather than mechanically).)

Rev. UCC §5-117 authorizes subrogation in any case where a "true guarantor" would be subrogated under state law. The fact that the issuer can't dishonor by asserting the applicant's defense *before* payment does not preclude assertion of a similar claim by subrogation *after* payment. In short, an issuer who pays off the beneficiary can jump into the beneficiary's shoes and take advantage of a real estate mortgage, an Article 9 security interest, or perhaps the guaranty of another party. The clear rule set forth by Rev. UCC §5-117 should slow down litigation in this area. The revision also makes it clear that an applicant who reimburses an issuer is subrogated to any rights of the issuer against the beneficiary.

Damages for wrongful dishonor. Although the courts have generally not allowed recovery of consequential or punitive damages in favor of a beneficiary if the issuer wrongfully dishonors a draw under a letter of credit, current Article 5 is not clear on this point. Rev. UCC §5-111 expressly prohibits recovery of consequential damages for wrongful dishonor and Comment 4 indicates that punitive damages are also precluded. The rationale of the drafters is that "imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic." (Rev. UCC §5-111, Comment 4.)

That's the bad news for beneficiaries. The good news is that reasonable attorney fees and other expenses of litigation (such as expert witness fees) *must* be awarded to the prevailing party in a wrongful dishonor action. This is one of the few times that a UCC provision allows attorney fees under the "American Rule."

Short statute of limitations. Under the current version of Article 5, there is no statute of limitations; letter of credit disputants must turn to more general statutes of limitations under state law. Tracking revised Articles 3 and 4, revised Article 5 contains its own statute of limitations—one year from the expiration date of the letter or one year after breach, whichever occurs later. The limit is short because the drafters believe that an aggrieved party's injury will be immediately apparent upon breach, and that long delays are counterproductive.

Issuer as account debtor. Just as a letter of credit is a species of receivable in favor of the beneficiary, issuers are a species of account debtor, terrified about getting caught in the middle of a dispute between the beneficiary and the beneficiary's assignee. Which party should be paid once a draw occurs? In response to this concern, revised Article 5 gives issuers more power than they currently have to insist upon certain kinds of documentation before they must recognize an assignment of proceeds from the beneficiary to a third party (including the beneficiary's lender).

Rev. UCC §5-114 allows the beneficiary to assign all or part of the proceeds of a letter of credit. The beneficiary may do so before presentation; this is a present assignment of its right to receive proceeds contingent upon the beneficiary's compliance with the terms and conditions of the letter. However,

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an issuer need not recognize an assignment of proceeds until it *consents* to the assignment. An issuer has no obligation to consent, but consent may not be unreasonably withheld "if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition of honor." In short, absent possession of the letter of credit the assignee can force the issuer to pay it directly only if the issuer consents.

However, consent of the issuer is *not* required in order for the assignee to perfect a security interest in the proceeds, good against a trustee in bankruptcy or other third party. Under the revision, the issue of perfection is taken out of Article 5 and placed in Article 9. (We discuss the perfection issue further in our next story.)

Successor of beneficiary. Under the rule of strict compliance, what happens when the draw is not made by the original beneficiary but by a successor who takes over by operation of law? Must the issuer refuse the draw on the ground that the original letter of credit called for draws by the original beneficiary only? This issue has generated some interesting litigation under current Article 5, with the courts generally holding that a legal successor (such as a trustee in bankruptcy, a receiver, or a state insurance commissioner) can assert the same rights as the original beneficiary. (See, e.g., *FDIC v. Bank of Boulder*, 911 F2d 1466, 12 UCC Rep.2d 321 (10th Cir. 1990)(FDIC, as receiver of failed bank, allowed to draw on standby letter).) Rev. UCC §5-113 wisely codifies these cases.

Warranties. Under current UCC §5-111, by drawing under a letter of credit the beneficiary warrants that the necessary conditions of the credit have been complied with. This rule could be construed to mean that the beneficiary warrants that the documents comply on their face. It could also be construed to allow an issuer to refuse payment and then justify its refusal by claiming that the beneficiary breached its warranty.

On the theory that only the issuing bank should judge compliance of documents, Rev. UCC §5-110 limits the beneficiary's warranty. It warrants only that (1) there is no fraud or forgery of the kind that would justify an injunction and (2) "the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit." Moreover, the revision provides that the more limited warranties don't arise until the issuer has honored the draw; if the issuer dishonors, no Article 5 warranties arise. Still, if a warranty is breached, the applicant has a direct cause of action against the beneficiary.

Issuance, revocation, amendment and duration. Rev. UCC §5-106(a) makes a letter of credit enforceable against the issuer when the issuer *sends* or otherwise transmits it to the beneficiary; under the current version of §5-106, it becomes effective only upon *receipt* by the beneficiary. Rev. UCC §5-106(a) also provides that a letter of credit is irrevocable unless it provides otherwise; this new rule reverses the presumption of revocability found in current Article 5 and brings the UCC into line with the UCP on this point.

Rev. UCC §5-106(b) makes it clear that no party to a letter of credit can be adversely affected by an amendment unless that party consents. Finally, Rev. UCC §§5-106(c) and (d) give a letter of credit a one-year duration if it has no stated expiry date and a five-year duration if it states that it is "perpetual." We know of cases under current Article 5 where a bank was forced into an unfavorable settlement with a beneficiary because the letter had no stated expiry date. The revision will help issuers in these cases.

Nondocumentary conditions. Draws under letters of credit should be honored or dishonored based on documentary compliance only. Sometimes issuers seek to dishonor on the basis of nondocumentary conditions that go to the heart of the underlying contract. For example, a letter might state on its face that shipment of the goods is not to be made "on ships more than 15 years old." Such a condition might be considered binding under general contract law, though it clearly defeats the independence principle.

In support of the independence principle, Rev. UCC §5-108(g) provides that the issuer "shall disregard" nondocumentary conditions. On the other hand, as indicated in Comment 9 to Rev. UCC §5-108, "[w]here the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely."

Benefits to issuers, applicants and beneficiaries. Like legislation in general, revised Article 5 was drafted with the advice (and lobbying pressure) of competing interest groups—issuers, applicants and beneficiaries. As indicated in the Prefatory Note to revised Article 5, there is something in the new law for everyone:

For issuers, there is the prohibition against consequential and punitive damages upon wrongful dishonor; the short one-year statute of limitations; a good choice of law provision in Rev. UCC §5-116; more protection upon assignment

of proceeds; broader rights of subrogation upon payment; and clear recognition of the UCP, particularly in international transactions.

For applicants, there is the direct cause of action available against a beneficiary who breaches a warranty upon presentation; a strict compliance standard for documents; greater subrogation rights following reimbursement of the issuer; continued right to injunctive relief in limited situations; and limits on general disclaimers and waivers under Rev. UCC §5-103(c).

For beneficiaries, there is the provision that a letter of credit is irrevocable unless it states otherwise; a clearer preclusion defense if the issuer fails to give a bill of particulars regarding dishonor; a clearer rule on timeliness of the issuer's examination of documents; recognition given to the successor of the beneficiary by operation of law to make presentation and receive payment; and recovery of attorney fees and costs if the issuer wrongfully dishonors.

Bottom line. Revised Article 5 makes no big conceptual changes in letter of credit law, but it clarifies ambiguities under present law, it fits better with the UCP, standard bank practice and new developments in technology, and it nicely balances the rights of all three parties—issuers, applicants and beneficiaries. It should be enacted quickly by all the state legislatures. Even before enactment in a particular state, it can be used effectively as "legislative history" to fill gaps in the current version of Article 5.

Perfecting Security Interests In Letter Of Credit Proceeds: New York Federal Court Thwarts Assignee

In the hands of the beneficiary, a letter of credit is a valuable asset, first kin to an account receivable, with the issuing bank as account debtor. If the beneficiary needs a secured loan, it can assign as collateral the right to payment from the issuing bank, even though it retains the right to draw. For the secured lender, the tricky issue is how to perfect.

UCC §5-116(2) provides that a collateral assignment of proceeds due under a letter of credit is perfected by the assignee's *taking possession of the original letter or its advice.* Filing won't do the job. Except for the possession requirement, the assignment is treated as a security interest in an Article 9 "account." That same section permits the issuer of a letter to honor drawings by the beneficiary until it receives a notice of assignment signed by the beneficiary that reasonably identifies the credit involved and contains a request to pay the assignee directly. This "direct pay" provision is parallel to the Article 9 rule (§9-318) dealing with account debtors in more traditional receivables financing.

A recent federal court decision from New York illustrates the problems that can arise when the assignee seeks to perfect its security interest in the proceeds. Unfortunately, the revised version of Article 5 does not solve the problem.

The *Weyerhaeuser* case. In *Weyerhaeuser Co. v. Israel Discount Bank of New York*, 895 F. Supp. 636, 27 UCC Rep.2d 1112 (SDNY 1995), Bank Leumi issued a $1.6 million standby letter of credit for the benefit of Crestmanor Homes, Inc. (CHI), a seller of modular homes to Israeli citizens. Israel Discount Bank (IDB) served as advising bank, receiving the documents to be presented by CHI, forwarding those documents to Leumi, and disbursing proceeds to CHI as beneficiary after Leumi honored draws. At the time of each presentment, CHI forwarded the original letter of credit to IDB to be used in determining whether the documents complied with its terms. IDB would then return the original letter to the beneficiary upon the issuer's payment of that draw.

CHI owed Weyerhaeuser approximately $1.5 million for building products sold on open account. CHI was in financial difficulty and unable to make payments to Weyerhaeuser and its other creditors. After several draws representing shipments of modular homes to Israel had been made on the letter of credit, Weyerhaeuser took a security interest in any further proceeds, filed a UCC financing statement, and got CHI to send a letter to the advising bank instructing IDB to disburse 49% of any further proceeds directly to Weyerhaeuser.

IDB never acknowledged the assignment. Instead, it continued to make payments directly to CHI, which applied them to other debts. Weyerhaeuser sued IDB for recovery of all payments made to CHI from letter of credit proceeds following the letter notice of Weyerhaeuser's security interest. In the meantime, CHI went bankrupt.

Advising bank not a "bailee" of assigned l/c. The issue was whether Weyerhaeuser had a perfected security interest in the post-notice proceeds. If so, IDB had a duty to pay the proceeds directly to Weyerhaeuser as assignee rather than to CHI as beneficiary. The court concluded that UCC §5-116(2) controlled. Under that provision, the assignment was ineffective until the original letter of credit or its advice was "delivered" to the assignee. Notice alone was not enough.

Weyerhaeuser argued that, under UCC §9-305, a proper substitute for delivery to the assignee itself is delivery to a third-party "bailee" with notice of the assignment. Weyer-