

# A lender's dilemma in the digital age: what lenders should be doing to access electronic books and records

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The digitization of information and technological advancements within companies, in addition to the new realities of remote work, have permanently changed the landscape for doing business. In legal and commercial businesses, facilitating loan transactions and credit agreements between lenders and borrowers has become more complex in the digital age.

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Lenders and borrowers, alike, still rely on provisions in credit agreements that no longer reflect the realities of virtual business practices. Lenders and borrowers may also share feelings of uncertainty and doubt as to each party's rights and remedies upon default,<sup>1</sup> including how and when a lender can access a borrower's digital books and records.

However, both lenders and borrowers can work together to incorporate explicit, unambiguous terms and remedies into their agreements to prevent confusion and delay when a borrower defaults and a lender needs to access the books and records of the borrower.

This article will look at the terminology that some lenders are beginning to use in credit agreements to access digital books and records more easily. This article will also propose some solutions and suggestions to the broader struggles of doing business and negotiating credit agreements in an increasingly digital world.

## The Uniform Commercial Code (UCC)

The Uniform Commercial Code (UCC) is the preeminent source of business law that guides business transactions and lays out the traditional rights and remedies between lenders as secured parties and borrowers as debtors.<sup>2</sup> Adopted in all 50 states, the UCC provides a reliable and consistent framework by which lenders and borrowers can perform transactions with statutory guidance and protections.<sup>3</sup>

It does so by "attempt[ing] to provide a simple, effective system of creating and perfecting, and determining the priority of, security interests in personal property in a manner that facilitates financing transactions in the real world."<sup>4</sup>

While the UCC, enacted in 1953, has been revised and amended many times since its enactment,<sup>5</sup> the Code, along with the secured parties and debtors that rely on it, have not yet fully addressed or modified contractual language that may no longer be applicable or may be hard to decipher in 2022.<sup>6</sup>

Article 9 of the UCC, which governs secured transactions and establishes the rights and remedies of a secured party, is one of the most important sections for guiding lenders and borrowers through secured transactions.<sup>7</sup>

However, many secured parties continue to use provisions which result in ambiguity in the rights and remedies of a secured party in a digital world.

## UCC Article 9 and lenders' statutory remedies

Article 9 of the UCC governs the relationship between borrowers and lenders and the rights and remedies of lenders in secured transactions. Secured transactions are contractual arrangements by which borrowers, also known as debtors, pledge property or collateral to secure loans from lenders, otherwise known as the "secured party."<sup>8</sup>

In essence, "Article 9 of the Uniform Commercial Code governs the creation, perfection, priority, and enforcement of security interests in most types of personal property and fixtures."<sup>9</sup>

Article 9 also provides statutory remedies to secured parties, regardless of whether they are expressly provided for in the security agreement with the borrower.<sup>10</sup> Under Article 9, lenders' rights "include the *right to collect on collateral*, the right to repossess collateral, the right to sell or dispose of collateral, and the right to retain the collateral in full or partial satisfaction of the debt with the borrower's consent."

In order to exercise the right to collect on collateral, a secured party must be able to notify Account debtors of the lender's security interest in the Accounts of the account debtor and to direct each account debtor to make payment directly to the lender.

In order to provide such notice, the lender must know who the account debtors are and how much they owe to the lender. To address this, lenders have typically included provisions in their credit agreements which allow the lender to take or make copies of the borrower's books and records from the borrower's place of business.

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These remedies are typically only available to secured parties after a borrower defaults under the security agreement. While there is no statutory definition for "default" under Article 9, they often include "failure to pay or comply with covenants, misrepresentations, judgments against the debtor, bankruptcy, and defaults under other agreements."

### Books and records

One of the biggest technological advancements for businesses and organizations in the past few decades has been the shift from physical recordkeeping to electronic recordkeeping. At the time that Article 9 was adopted and revised,<sup>11</sup> companies kept physical books and records of their Accounts. To collect on the Accounts of a defaulting borrower, all a secured creditor had to do was go to the borrower's place of business and take, or make a copy of, its books and records.

Today, however, most of these records are purely digital. They are stored on web servers or clouds that are inaccessible to people outside of the organization.<sup>12</sup> While lenders have a right under the UCC to access a borrower's books and records, lenders are failing to explicitly draft credit agreements which provide access to *digital* books and records.

Lenders must navigate the new technological barriers that make accessing a borrower's Accounts and books and records more difficult to do now than doing so was in the past. This is because a lender's right to collect payment from a defaulting borrower and its account debtors, as set forth in Section 607 of UCC Article 9, is one of the most attractive and effective remedies for secured parties.<sup>13</sup>

A lender's right to collect is a fast and simple remedy, allowing the secured party to access the debtor's liquid assets without necessarily disrupting the debtor's business.<sup>14</sup>

However, in order to collect Accounts from a defaulting debtor's, secured lenders need access to the borrower's books and records to determine who owes the borrower money, how much is owed, and how to notify each account debtor.<sup>15</sup> Without current information, a secured party will lack the means to quickly enforce its security interest on Accounts.

Whether a lender can access a borrower's books and records will also likely determine whether the lender pursues judicial or non-judicial foreclosure. "While judicial foreclosure provides the comfort and clarity of court orders, it is time consuming and often expensive."<sup>16</sup>

Because of this, many lenders prefer non-judicial foreclosure to "avoid the delay and expense attendant with the courtroom." Non-judicial foreclosure, however, is usually only plausible if the borrower is willing to provide access to its digital books and records.

If a lender is unable to access a borrower's digital books and records, the secured party "may have no choice but to seek judicial relief." Because the judicial process may be an additional burden on the secured party, it provides one more reason for secured parties to clearly define their rights and remedies at the *outset* of their relationships and in their *written* agreements.<sup>17</sup>

### Suggestions

Some of the terminology and contractual arrangements derived from UCC Article 9 have not kept up with the realities of negotiating agreements in the digital age. Rather than relying on precedential loan language, lenders and borrowers need to negotiate terms that allow lenders to gain access to borrower's digital records upon default.

Among other things, lenders should include language in their credit agreements that provides them with passwords and access to digital information and which requires the borrower to update and confirm this information on a periodic basis.

Some standard provisions of the typical credit agreement should also be revised to allow the lender continuous access to electronic records.

First, the definition of books and records found in the credit agreement should include all computer programs, tapes, disks and related records, whether tangible or intangible in nature. It should be clear that the lender is at all times entitled access to both tangible and intangible records of the borrower.

Second, the borrower should agree that the lender's right to access the borrower's books and records should specifically include the right to access all servers and cloud platforms maintained by, or for the benefit of, the borrower. This could require that the borrower provide the lender with a current list of platforms and servers used by the borrower.

In addition, the lender should require that it be given a unique username and password. This would ensure that the lender has continuous access to all electronic records. The failure to provide such access should constitute an event of default under the credit agreement.

Third, the lender should require landlord lien waivers at all locations where books and records are held, including all locations where servers are maintained. The borrower should have an affirmative obligation to notify the lender if at any time it changes the location of, or the identity of, any servers, cloud platforms, or places where electronic data is kept or maintained.

The borrower should be required to provide the lender with immediate access thereto, including a unique username and password.

Similarly, the credit agreement should provide that the borrower (1) shall not move its chief executive office from the location set forth in the credit agreement; and (2) shall not permit its books and records (or servers which contain information or data not available at its chief executive office) to be located at any location not set forth in the credit agreement.

*Lenders would be ... wise to negotiate how they acquire access to the borrower's servers and cloud platforms and how they bypass potential security barriers to acquire the necessary books and records.*

It may also be appropriate as part of the borrower's periodic financial reporting or compliance reporting to require that information on electronic books and records be confirmed or updated. Affirmative covenants to pay the borrower's obligations as, and when, due should include specific references to any leases which pertain to servers, platforms, or other places where electronic data is maintained.

While including the above changes is a start, lenders would be even more wise to negotiate how they acquire access to the borrower's servers and cloud platforms and how they bypass potential security barriers to acquire the necessary books and records.

Establishing and defining the ways in which lenders will acquire digital books and records from borrowers will prevent future delays, litigation, and additional costs. Lenders and borrowers can refer to their credit agreement knowing how and when intangible books and records must be provided to the lender.

Incorporating new language and definitions in credit agreements will not only benefit the current parties to the loan but will also benefit future parties who can rely on the new terminology and provisions that reflect the current ways of doing business.

New technology and virtual business practices are not slowing down any time soon. While UCC Article 9 may be slow in adapting to technological advancements, lenders and borrowers can get ahead of any potential confusion by openly acknowledging their business practices and methods of storing books and records.

By including explicit provisions in security agreements that give lenders access to server-based books and records, lenders will be

able to enforce their rights and remedies more easily under the UCC and avoid the need for judicial intervention.

## Notes

<sup>1</sup> See Richard J. Hunter, Jr. and John H. Shannon, *Managing Financial Stress for Debtors and Creditors in the Midst of a Pandemic, Part I: Security Interests under Article 9 of the UCC*, 5 Int'l J. of Bus. Mgmt. 11 ("[B]oth debtors and creditors have become increasingly uncertain as to their rights and obligations upon default.").

<sup>2</sup> See Norman D. Farnam and Krista R. Pleviak, *Revised UCC Article 9: Compliance Tips for Creditors and debtors*, 86 Wis. Lawyer 24, 25 ("The UCC, which all 50 states and the District of Columbia have adopted, also governs sales of goods, leases, negotiable instruments, bank deposits and collections, letters of credit, documents of title, and investment securities.").

<sup>3</sup> See Hunter and Shannon, *supra* note 3, at 12 ("The Uniform Commercial Code (UCC) provides a "method of analysis" to understand the complexity of issues relating to security for creditors and debtors.").

<sup>4</sup> See Steven O. Weise, *Perfection by Possession: The Need for an Objective Test*, 29 Idaho L. Rev. 705 (1993).

<sup>5</sup> See generally Uniform Commercial Code, Unif. L. Comm'n, <https://bit.ly/3T5b8LV> (noting the revisions and amendments to the various Articles of the UCC since its enactment in 1953).

<sup>6</sup> See Shawn Burton, *The Case for Plain-Language Contracts*, Harv. Bus. Rev. (Jan./Feb. 2018) <https://bit.ly/3wjg5la> ("We should live in a world where contracts are written in accessible language — where potential business partners can sit down over a short lunch without their lawyers and read, truly understand, and feel comfortable signing a contract. A world where disputes caused by ambiguity disappear.").

<sup>7</sup> See UCC Article 9, *Secured Transactions*, Unif. L. Comm'n, <https://bit.ly/3wgruHQ> ("Article 9, Secured Transactions, may be the most important of the eleven [UCC Articles]. Article 9 provides the rules governing any transaction ... that couples a debt with a creditors interest in a debtors personal property.").

<sup>8</sup> David M. Steingold, *Priority of Creditors in Secured Transactions*, NOLO (2013), <https://bit.ly/3Pvzlm9>.

<sup>9</sup> Farnam and Pleviak, *supra* note 2.

<sup>10</sup> *Remedies Outside the Box: Enforcing Security Interests Under Article 9 of the Uniform Commercial Code*, ABA (Aug. 31, 2012), <https://bit.ly/3Ceksad>.

<sup>11</sup> See *Uniform Commercial Code*, Unif. L. Comm'n, <https://bit.ly/3T5b8LV> ("A substantial revision to Article 9 was completed in 1998 and adopted in all states. The article was further amended in 1999, 2000, 2001, and 2010.").

<sup>12</sup> See *Share of Corporate Data Stored in the Cloud in Organizations Worldwide From 2015 to 2022*, Statista (Mar. 28, 2022) ("As of 2022, over 60 percent of all corporate data is stored in the cloud. This share reached 30 percent in 2015 and has continued to grow as companies increasingly shift their resources into cloud environments in the hope of improving security and reliability next to advancing business agility.").

<sup>13</sup> See Garry M. Graber and Steven W. Wells, *UCC Article 9 Secured Party Sales, Practical Law*, <https://bit.ly/3PCSeJl> ("Section 9-607 of the UCC provides that when a defaulting debtor has pledged its accounts as collateral, the secured creditor has the right to collect payment directly from those accounts.").

<sup>14</sup> See *Remedies Outside the Box*, *supra* note 11 ("The right to collect is an attractive remedy for secured parties because it is often the fastest remedy available, allows the secured party to act without disrupting the debtor's business, and provides access to liquid assets.").

<sup>15</sup> See generally UCC § 9-601.

<sup>16</sup> Michael A. Nardella, *Non-Judicial Foreclosure of Aircraft Collateral: Unique Challenges for Lenders*, 7 Pratt's J. Bankr. L. 436 (2011).

<sup>17</sup> See Hunter and Shannon, *supra* note 1, at 17 ("Article 9 of the UCC provides the parties with a workable framework in which ... issues can be adjudicated in an orderly manner so that the parties can adequately plan for reasonable capitalization of their businesses and protection of the parties' rights.").

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