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Avoiding the Perils of Post-UCC Filing Changes to Debtor or Collateral Information

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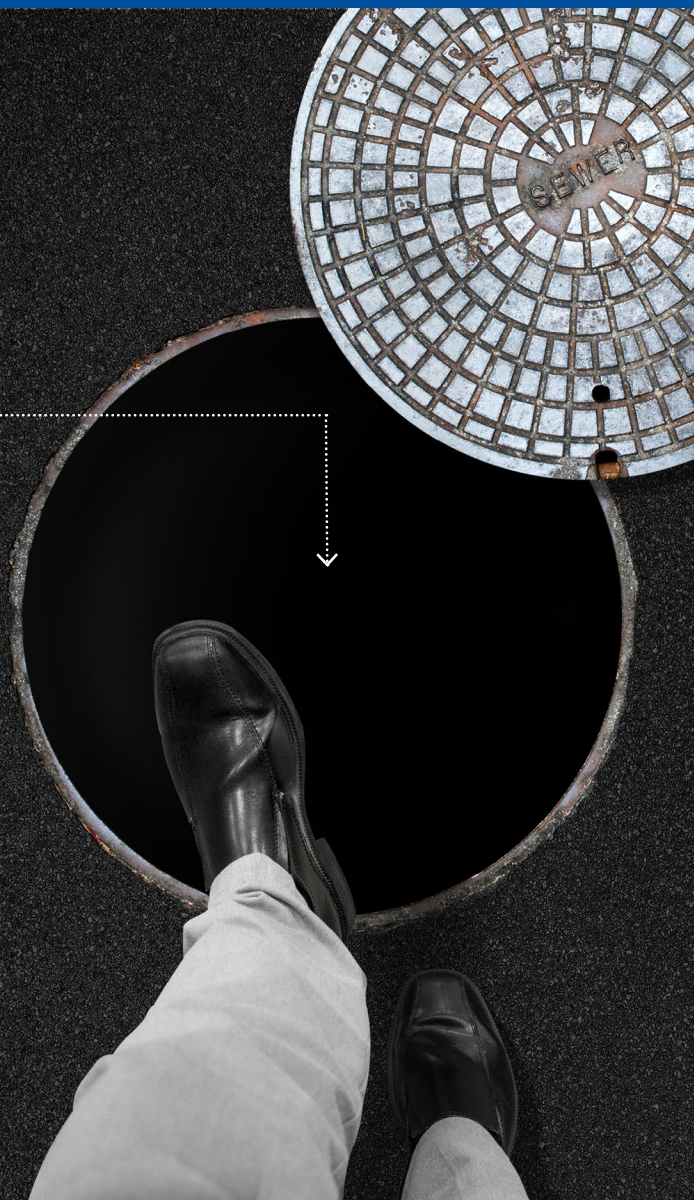

A secured party cannot relax after it perfects its security interest by filing a UCC financing statement. Ongoing diligence is essential, because subsequent events that affect the information provided in the filed financing statement could threaten the secured party's ability to enforce its security interest.

Not every post-filing event that changes debtor, secured party, or collateral information will have an impact on the effectiveness of a filed financing statement. However, in some specific situations, UCC Article 9 requires the secured party to take action within short statutory deadlines, *even if the secured party lacks actual knowledge of the relevant events*. The secured party's failure to comply may cause the security interest to become fully or partially unperfected.

This white paper identifies the events that create an affirmative duty for the secured party to take action, what actions are required for the secured party to maintain the perfection and priority of its security interest, and the strict statutory deadlines within which the secured party must act. It also offers best practice suggestions for tracking critical post-filing changes.

Debtor name change

The retrieval system for UCC financing statements is based on the debtor name. Consequently, it is essential that a financing statement provide the correct debtor name required by Article 9. If the debtor name on a financing statement is incorrect and a search of the correct debtor name using the filing office's standard search logic, fails to disclose the record then the insufficient name makes the financing statement seriously misleading and ineffective to perfect the security interest.

The stakes are high, so secured parties normally take great care to provide the correct debtor name on financing statements. However, a debtor name can change at any time. A registered organization can change its name simply by amending the entity's public organic record. Any change to an individual's driver's license could cause a name-change event. Other types of debtors may quietly change their name without any notice.

If a debtor name change occurs after the filing of a financing statement, a search under the new correct debtor name may not locate records filed under the former debtor name. The result is a risk of hidden liens that must be allocated between those who file and those who search UCC records.

Article 9 allocates the risk of debtor name changes based on whether the collateral existed at the time of the name change or was later acquired. Under UCC § 9-507(c), if the name of the debtor changes so that it no longer complies with the requirements of § 9-503(a) and renders the filed financing statement misleading, then the financing statement remains effective to perfect the security interest in collateral acquired by the debtor before, or within four months after, the financing statement becomes seriously misleading. This protects the secured party's security interest in existing collateral by placing a duty on interested parties to search under the debtor's prior names. However, the secured party must take action to protect the security interest in after-acquired collateral.

To remain perfected in after-acquired collateral, § 9-507(c)(2) requires the secured party to file an amendment that renders the financing statement not seriously misleading within four months after the record became seriously misleading. To make the financing statement not seriously misleading, the secured party simply needs to file a UCC3 Amendment that adds the new name to the record.

New debtor becomes bound by security agreement

In some cases, a new party may become bound by a security agreement entered into by the secured party's original debtor. This might occur due to a merger, acquisition, or other event that binds the new party by the agreement under state law.

If the new debtor's name is sufficiently different that it renders a financing statement naming the original debtor seriously misleading, then the secured party will need to take action. Otherwise, the secured party will become unperfected for after-acquired collateral.

Under § 9-508(b)(1), if the difference between the name of the original debtor and that of the new debtor causes a filed financing statement to become seriously misleading, then the financing statement remains effective to perfect the security interest in collateral acquired by the new debtor before and within four months after the new debtor becomes bound by the security agreement.

As with a debtor name change, the secured party must take action to remain perfected in collateral acquired more than four months after the new debtor becomes bound by the security agreement. Under § 9-508(b)(2), the secured party must file an *initial financing statement* that provides the name of the new debtor before expiration of that four-month period (emphasis added). While it appears from this language that a UCC-3 debtor name amendment would not be sufficient, Official Comment 5 to § 9-512 suggests that a UCC-3 amendment to add the new debtor name would satisfy the "initial financing statement" requirement in at least some cases.

In some cases, the new debtor may be located in a different jurisdiction than the original debtor. When this occurs, determining the secured party's responsibilities and applicable deadlines becomes more complicated as the event may cause a change in the governing law.

Change in governing law

A change in the law governing perfection and priority occurs either when a debtor relocates in such a way that its location changes for purposes of § 9-307 or when a new debtor that becomes bound by the security agreement is located in a different state. Many events can change the governing law, including when a registered organization redomesticates to a different state, a non-registered organization moves its place of business or chief executive office across state lines, or when an individual moves his or her principal residence to a new state. Likewise, mergers, acquisitions, assumptions, and transfers of collateral could cause a change in the governing law.

A change in the governing law requires prompt action by the secured party. Under § 9-316(a), the secured party must file a financing statement naming the correct debtor in the new jurisdiction within a potentially very short time following the event. If the secured party fails to file within the applicable timeframe, its security interest will become unperfected, even with respect to collateral acquired before the change.

The statutory deadlines set forth in § 9-316(a) vary depending on the circumstances. The secured party has no more than four months to file a financing statement after the debtor changes its location to another jurisdiction. The secured party may have up to a year to file its financing statement following transfer of collateral to a person that becomes a debtor and is located in another jurisdiction. Regardless, the secured party must act before the original financing statement filed in the old jurisdiction would lapse, even if that results in a much shorter period of time than would otherwise apply.

Transfer of collateral

Ordinarily, a security interest follows the collateral. Thus, if a debtor sells or otherwise transfers collateral to another party, the secured party generally remains perfected without further action.

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There is one big exception to the general rule. Under § 9-320(a), a buyer of goods in ordinary course of business ("BIOC") takes free of a security interest created by the seller, even if the buyer is aware of the security interest. In that case there is nothing the secured party can do to enforce its security interest against the buyer or collateral. It is left to enforce its security interest against the proceeds of the sale or other secured assets of the debtor. Consequently, there is nothing that the secured party can or should file to protect its security interest.

If, however, the transferee is not a BIOC and is located in the same jurisdiction as the debtor, then the security interest remains perfected against the collateral and proceeds under § 9-315(a) without further action. The secured party generally does not need to file a UCC-3 amendment or new financing statement to preserve its rights. In fact, amending the financing statement to change the debtor to the transferee can actually cause the security interest to lose priority. Any amendment should add, not change, the debtor.

A transfer of collateral generally only requires action by the secured party when the transferee is located in a different jurisdiction than the original debtor. Such a transfer would cause a change in the governing law. In that case, the secured party needs to file a financing statement in the new jurisdiction before the earlier of the lapse date of the original financing statement in the former jurisdiction, or one year after the change in governing law.

Tracking post-filing changes

The greatest challenge for a secured party is identifying critical debtor or collateral changes while there is still time to act before the statutory deadline. This is no easy task. While the debtor ordinarily has an affirmative duty to notify the secured party of relevant changes to its name, organization structure and transfers of the collateral, as a practical matter, secured parties generally cannot rely on the debtor to provide timely information, if the debtor provides it at all.

A secured party must take any necessary action before the applicable deadline following the change, regardless of whether the debtor provided notice. Failure to act in time will cause the security interest to become unperfected in after-acquired collateral or, following a change in the governing law, all of the collateral. The secured party has a lot to lose in these situations. Therefore, the secured party must take sole responsibility for tracking post-closing changes.

Not all changes can be easily tracked. Much will depend on the nature of the event and the type of debtor involved.

Transfers of collateral may not leave an obvious audit trail. The secured party may only learn that a debtor has transferred collateral subject to a security interest through regular inspections of the premises. Likewise, unless the secured party remains in regular communication with the debtor, it may not discover the relocation of an individual or non-registered organization across state lines.

On the other hand, registered organization changes are comparatively easy to track, with the exception of transfers of collateral. A registered organization must file a public record to make changes to its name, business structure or location. A secured party can use the public information to identify these changes and still have plenty of time to take the required responsive action.

Fortunately, most commercial transactions involve LLCs, corporations, and other registered organization debtors. There are two ways to track registered organization changes through public records. One is to have someone manually search the state business records for each debtor every 2-3 months. However, this method requires significant costs in filing office access fees and personnel resources.

As an affordable alternative to manual public record searches, some third-party vendors (including **Corporation Service Company®**) offer automated tracking systems. These tracking tools alert the secured party of any changes to a debtor's public organic records. The secured party generally receives an alert of potentially critical changes within 30 days of the event, but often much sooner. The alert provides the secured party with plenty of time to investigate and, if necessary, file any UCC records required to keep the security interest fully perfected.

The decision of whether to manually track changes or use an automated system depends on the size of the portfolio involved and the secured party's available resources. Regardless of which method a secured party chooses, both are effective for identifying important debtor changes.

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Conclusion

The stakes are high when certain post-filing events require the secured party to take action. Fortunately, the secured party can easily protect its perfection and priority by filing the appropriate UCC records before the applicable statutory deadline. However, the secured party cannot use lack of knowledge as an excuse for its failure to comply within the short time limits. Therefore, each secured party should ensure that it has an effective post-filing monitoring program in place to identify debtor and collateral changes while there is still time to act.

For more information:

Please contact Corporation Service Company for more information about automated tracking systems that can help your company identify relevant post-filing events.

About the Author

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