



How to Maintain Perfection and Priority

When Changes Occur After Closing

by Robert W. Ihne

One of the most difficult subjects under revised Article 9 is also one of the most important to be able to put into practice: knowing what must be done to maintain the perfection and priority of your security interest after various changes have taken place following the initial booking of a deal. These include a change in the debtor's name, a change in the debtor's location, a sale of the collateral to a different debtor, a merger of the debtor into another organization, and even changes you might think no longer matter under revised Article 9.

This article addresses perfection and priority based upon filing and encompasses the vast majority of secured transactions. It is meant to be a handy guide that highlights when action needs to be taken and explains what needs to be done. Issues covered are: (1) whether you need to amend your existing filing; (2) whether to do a new filing, and, if so, whether you need to keep your original filing alive by continuing it when the time comes; and (3) the extent to which you will be able to maintain priority over other perfected secured creditors.

If your collateral is limited to items in existence at the time your deal closed (e.g., specific pieces of equipment),

some of the rules described below will be simpler to apply. However, if your security interest also encompasses collateral acquired by your debtor in the future (so-called "after-acquired collateral"), certain rules become more complex.

Whenever the discussion below calls for a new filing (whether an amendment or an entirely new filing) within a certain period of time to remain perfected, it is assumed that the original filing is not itself scheduled to expire during that time period before the new filing is to be made; or, if it is scheduled to lapse, it is assumed that it will be appropriately continued.

Change in the debtor's name

What if the debtor changes its name such that someone who searches under the new name would not find your original filing? If your security interest is only in specific collateral owned by your debtor and existing at the time of your deal, you need do nothing aside from continuing this filing (if necessary due to obligations secured by the collateral extending beyond the lapse date) in order to

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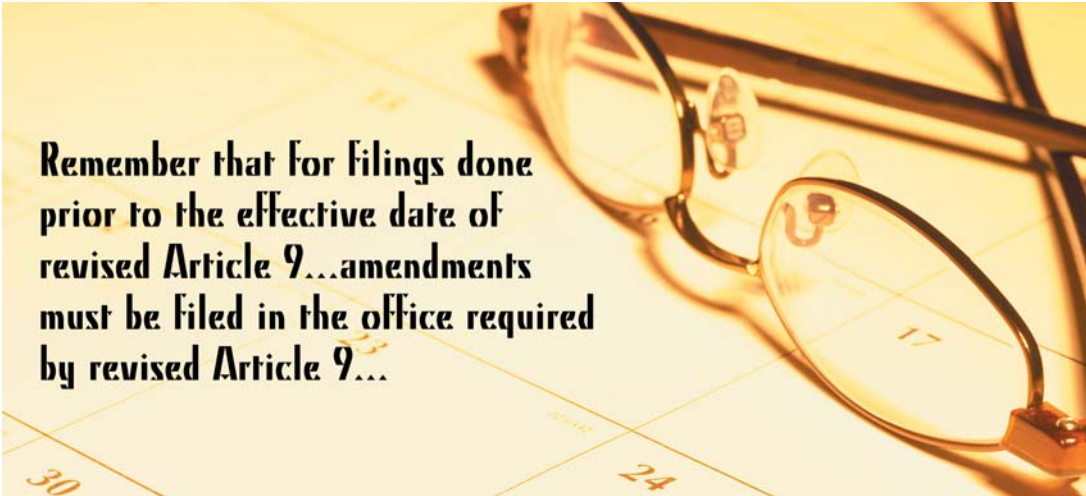
maintain your perfection and priority. Section 9-507(c)(1) provides that the original filing remains effective. To put others on notice, you might amend the filing to indicate the new name, but that would be unnecessary with respect to the existing collateral. Article 9 has always placed the burden on later secured creditors to inquire about changes in debtor's names and to consider searching under prior names.

If, however, your collateral includes after-acquired property (e.g., your security interest covers all accounts, inventory or equipment now owned or *hereafter acquired* by the debtor), you must file a financing statement amendment indicating the debtor's new name within four months of the name change, or you will not be perfected and will not retain priority in collateral acquired by the debtor more than four months after the name change. Section 9-507(c)(2) provides a four-month grace period during which your original financing statement will serve to perfect collateral acquired within four months after the name change (as well as any collateral in existence prior to the name change). However, the original filing will not serve to perfect in any collateral acquired thereafter.

Remember that for filings done prior to the effective date of revised Article 9 (July 1, 2001 in all states except Alabama, Florida and Mississippi — January 1, 2002 — and Connecticut — October 1, 2001), amendments must be filed in the office required by revised Article 9 and therefore could take either of two forms: (a) if the amendment is to be filed in the same office as the original filing, using the standard UCC3 Amendment form and appropriately completing boxes 1, 5, 6 and 7, or (b) if the amendment is to be filed in a different office, using the "in lieu" method of filing a completely filled-out initial UCC1 form along with the extra required information referencing the filing being amended.

Change in debtor's location

Under revised Article 9, the place to file with respect to most collateral is the debtor's location. Location has a special meaning under revised Article 9 that varies depending upon whether the debtor is a registered organization, an unregistered organization or an individual. If your debtor is an unregistered organization or an individual, and that debtor changes its revised Article 9 location by moving its chief executive office or principal residence, respectively, you have four months to file a new financing statement in the new location in order to maintain your perfection and priority as to collateral existing at the time the location is changed. Even if another creditor had filed in the new



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location prior to the time of your initial filing in the old location, if you had priority in the latter, that priority will continue. See Section 9-316(a)(2) (the four-month rule for maintaining perfection following a change in location).

Registered organizations do not usually change their location in this sense, which would mean changing the jurisdiction in which they are registered. The merger of a registered organization into an organization registered in another jurisdiction — perhaps even retaining the original debtor's name — should be analyzed under the "new debtor" rules discussed later in this article. But if state law does permit an organization registered in one state simply to convert to become the same entity in another state, the four-month rule discussed in the preceding paragraph applies. For example, California's Corporations Code, Sections 1150 et. seq., allows a business entity organized in another state to convert into a California corporation. Similarly, Section 18-214 of Delaware's Limited Liability Company Act describes how a limited liability company formed in another state may convert into a Delaware limited liability company. Since both of these conversion statutes speak in terms of the entity that emerges from the conversion process as being the same entity as before, there appears to be good reason to analyze this as a change in location of a single debtor, rather than as an assumption by a "new debtor" of the original debtor's obligations.

The story is different for collateral acquired by the debtor after a change in location, where your perfection and priority extend only from the date that you file in the new location. Unlike the case of a debtor name change, you do not become perfected on collateral acquired by the debtor at any time after the move — not even during the four-month grace period provided to remain perfected on collateral existing at the time of the move — without filing in the new location. Moreover, even if you file in the new location before or at the time of the change in location, and are thus perfected on all after-acquired collateral, you will lose to any

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creditors who had filed against the debtor on that after-acquired collateral in that new location before your filing. (There are no rules in Article 9 specifically addressing the effect of a change in a debtor's location on the perfection of a secured party's interests in collateral acquired by the debtor after this change. Section 9-316(a)(2) concerns the effect of such a change on security interests perfected under the law of the original location.

However, these conclusions concerning perfection and priority with regard to collateral acquired after the debtor has moved its location can be inferred from the perfection and priority rules in general.)

Once you have filed in the new location, there is no need to keep the original filing alive by continuing it before it is scheduled to lapse, but you should keep filed-stamped copies of that original filing to prove the date of that filing for priority purposes.

Sales of existing collateral

Unless you authorize a sale of existing collateral free of your security interest, the collateral generally remains subject to your security interest and you remain perfected (absent a change in location as described below) unless the buyer qualifies as a buyer in ordinary course of business (which would include, among other things, that your debtor is in the business of selling goods of that kind). See Sections 9-315(a)(continued attachment) and 9-507(a)(continued perfection by filing). Also (assuming you take the action called for below relating to a change in location), if you had a first priority security interest against your original debtor, you will prevail over any secured parties of such a buyer. See Section 9-325(a)(priority over secured parties of buyer, even those that might have filed prior to your filing against your original debtor).

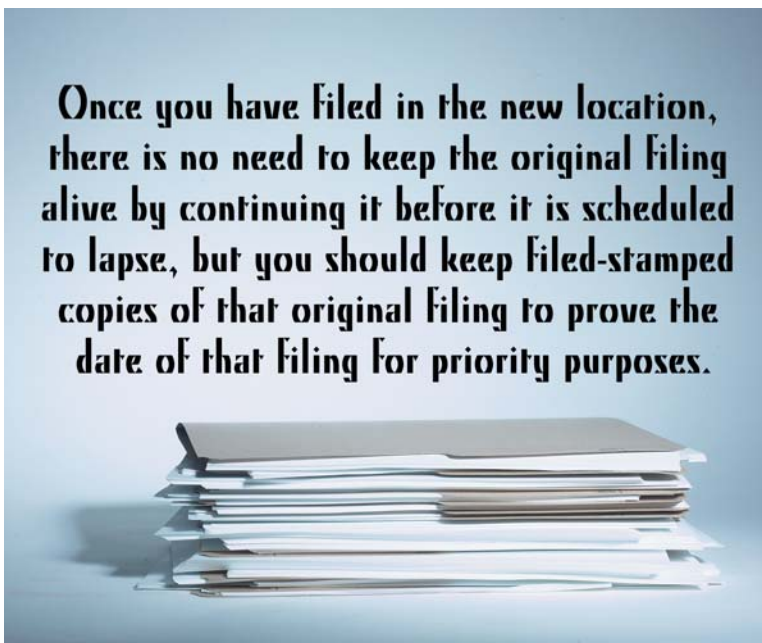
On the other hand, if your debtor is in the business of selling goods of the same kind as your collateral, there is a good chance that such a sale will be free of your security interest. See Section 9-320(a)(buyers in ordinary course take free). But to the extent that the debtor is not in such a business (or the buyer is disqualified for some other reason from being a buyer in ordinary course of business), Article 9 has always placed the burden on the buyer and secured creditors of the buyer to trace the ownership of the goods

purchased to determine if the seller (your debtor) might have created a security interest (yours) in those goods (your collateral).

The foregoing rules requiring no action (other than continuation of the original filing if there are obligations secured by the collateral that extend beyond the lapse date of the original filing) to maintain perfection and priority in

collateral that is sold to a buyer *not in ordinary course of business* must be qualified. However, when that buyer is located in a different jurisdiction, to maintain perfection and priority, you must file against the buyer in its location within one year after the sale. See Section 9-316(a)(3)(the one-year period to file against transferees located in another jurisdiction). Following such a filing against a buyer in a new location, continuation of the original filing against the seller will no longer

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be necessary, though you should retain filed-stamped copies of that original filing to prove the date of that filing for priority purposes.

Even if such a buyer is located in the same jurisdiction, it could be helpful — even though it is not required to maintain perfection or priority — to file against the buyer if you want to put creditors of the buyer on notice and want to receive any inquiries concerning the collateral. No specific authorization from the buyer is necessary, whether the buyer is in the same location or not. See Sections 9-509(c)(authority to file against the buyer) and 9-102(a)(28)(A)(definition of “debtor” which includes the buyer of your collateral). As stated above, if the buyer is located in the same jurisdiction, this is not necessary to maintain either perfection or priority. But should you decide it might be helpful to file against a buyer in the same location, do so by filing a new financing statement against the buyer — do not attempt to amend the filing against the original debtor by amending that debtor's name to change it to the name of the buyer. There is the possibility that adding such an amendment could result in a loss of priority.

Notwithstanding the comfort provided by Article 9 with respect to sales of collateral to buyers that do not qualify as being buyers in ordinary course of business, such sales often arise in the context of requests by honest debtors for you to approve of such sales and to have you agree that the buyer assume the obligations of the debtor

that the collateral originally secured. Such a situation is an example of the next change to be discussed — the emergence of a “new debtor.”

Transfer and assumption agreements and mergers: When your collateral comes to be owned by a “new debtor”

Some of the more complex rules related to perfection and priority following changes in ownership of your collateral involve a new concept defined by revised Article 9 — a “new debtor.” “New debtor” is defined to include a party that becomes bound under the original security agreement that was entered into by your debtor. Most commonly, this occurs either (a) when the new debtor agrees in a contract (such as a transfer and assumption agreement) to assume the obligations of your debtor under the original security agreement or (b) when your debtor (or substantially all of its assets) is acquired by or merged into the new debtor (whether the new debtor is a previously existing business or a new organization created to alter the legal structure of your debtor’s business) and the new debtor has become generally obligated for the obligations of your original debtor. See Sections 9-102(a)(56)(definition of “new debtor”), 9-203(d)(explaining when a party becomes bound by a security agreement entered into by an original debtor and thereby becomes a “new debtor”).

In such cases, it was not always clear under former Article 9 what was necessary to maintain perfection and priority in existing collateral and what the effect would be on after-acquired collateral, if any, covered by your security agreement.

With respect to your original debtor’s collateral in existence at the time the new debtor becomes bound, the rules in revised Article 9 regarding perfection and priority are the same as for the sale to a buyer not in ordinary course of business discussed in Section III above: (a) where the new debtor is located in the same jurisdiction, nothing need be done to preserve the enforceability, perfection and priority of your security interest (other than continuing your original filing), and (b) where the new debtor is located in a different jurisdiction, you have one year to file against the new debtor in that other jurisdiction, and if you do so during that period, nothing more need be done to preserve that enforceability, perfection and priority. See Sections 9-203(e)(you do not need to have the new debtor sign a new security agreement), 9-508(c)(the special new debtor rules of 9-508 do not apply to collateral transferred by the original debtor to the new debtor, which transfers are instead governed by 9-507(a)(continued perfection by the original filing with respect to collateral sold)), 9-325(a)(priority continues with respect to secured creditors of the new debtor, even those that may have filed prior to your filing against the original debtor), 9-316(a)(3)(the one-year period for filing against transferees located in a different jurisdiction). In the situation described earlier in this paragraph, although you will no longer need to continue your original

filing, you should retain filed-stamped copies of it to prove the date of that filing for priority purposes.

One example of the situation described in the previous paragraph would be a tax-motivated change of the state of organization of your debtor’s business effected by a sale of all that original debtor’s property to, and an assumption of its obligations by, a newly formed organization with the same name in another state. To all appearances, your debtor seems not to have changed in any significant way, having the same name and the same location for all of its offices and all its property. Yet, for Article 9 purposes, the location that you thought governed perfection has changed. The fact that such changes are difficult to monitor was the reason that revised Article 9 provides a full year in which to learn about the change and to file in the new location.

For those of you who extend credit in reliance on after-acquired collateral as well as collateral existing at the time of transfer to a new debtor, the rules become more complex. By becoming a new debtor — i.e., by becoming bound to your security agreement with the original debtor granting a security interest in after-acquired collateral — the new debtor has in effect granted you a security interest in its after-acquired collateral. See Section 9-203(e)(the new debtor’s after-acquired, as well as existing, collateral has become subject to your security interest without the necessity of the new debtor signing a security agreement with you). To maintain perfection in such after-acquired collateral of the new debtor, however, there are two things you may need to do: (1) if the new debtor is located in a different jurisdiction than the original debtor, you need to file a financing statement against the new debtor in that other jurisdiction *immediately after the new debtor becomes bound* to be perfected in collateral acquired after it has become so bound, or (2) if the new debtor is located in the same jurisdiction, but its name is different enough from the name of the original debtor that a search under the new debtor’s name would not turn up your filing against the original debtor, you have four months to file against the new debtor to remain perfected in collateral acquired by the new debtor after that four-month period. See Sections 9-508(a)(filing against the original debtor remains effective to perfect, even as to after-acquired collateral), 9-316(a)(3)(the one-year grace period for filing in a new location with respect to a security interest perfected in the old location does not apply in this context since a security interest in the new debtor’s after-acquired collateral had not attached, and therefore could not have been perfected, at the time the new debtor became bound), 9-508(b)(the four-month period for filing against a new debtor with a different name to be perfected in collateral acquired more than four months after the new debtor becomes bound).

With respect to the situation described in (1) in the previous paragraph, if your new filing in the new location

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includes the existing collateral transferred to the new debtor as well as after-acquired collateral, there will be no need to continue the original filing. You only need to keep filed-stamped copies to evidence the original filing date for priority purposes. However, with respect to the situation described in (2), *you must keep the original filing alive by continuing it (if necessary) even after you have done the new filing against the new debtor.* Unlike the situation in (1), which is governed by a rule stating that the original filing ceases to be effective with respect to the original transferred collateral one year after the transfer to a debtor in a different location (see Section 9-316(a)(3)(the one-year period to re-file following transfer to debtor in a different location), therefore there would be no point to continuing it. In the situation described in (2), it is the original filing that serves to continue perfection in that original transferred collateral, thus necessitating continuation if the obligations of the new debtor extend past the original lapse date. See Section 9-508(c)(the rule applying to original transferred collateral is found in 9-507(a)).

To these layers of complexity, we need to add one more, since we have not yet discussed your priority with respect to the new debtor's after-acquired collateral versus other secured creditors of that new debtor. If the new debtor has a secured creditor that had properly perfected its security interest in the new debtor's after-acquired collateral at the time the new debtor became bound to your security agreement, *that other creditor's security interest will rank prior to yours*, regardless of whatever filings you might do to maintain your perfection. See Section 9-326 (priority of security interests created by a new debtor). Official Comment No. 2 is especially helpful in interpreting this. Thus you should not rely on such new debtor's after-acquired collateral without searching for and dealing with any conflicting security interests.

Changes after the effective date of revised Article 9 that could have a negative impact on perfection based only on former Article 9 filings

One last topic needs to be considered, at least until the end of the transition period applicable to filings done under former Article 9 (until June 30, 2006 in most states). Like revised Article 9, former Article 9 had rules that caused financing statements to become ineffective after the occurrence of certain changes. For instance, former Article 9 contained much the same four-month rule with respect to changes of a debtor's name as found in revised Article 9. See former Section 9-402(7). If such a name change occurs now, the relevant former Article 9 filing must be amended in one of the two ways mandated by revised Article 9, i.e., either by an ordinary UCC3 Amendment if the office for filing remains the same as under former Article 9 or by an "in lieu" amendment in the new, correct filing office. The focus in this section is on changes that were significant under the rules of former Article 9, but have no impact

under revised Article 9 *except to the extent your perfection relies on filings made under former Article 9 in the "incorrect" office for revised Article 9.*

In addition to rules regarding changes in the debtor's name, former Article 9 also contained rules regarding changes in the physical location of certain types of collateral and changes in the physical location of the debtor (i.e.,



the location of the debtor's chief executive office, if an organization, or the debtor's residence, if an individual). See former Section 9-103(3)(d). For example, if goods other than those described as

mobile goods (see former Section 9-103(3)(a)) were moved to another jurisdiction, secured parties had only four months to file in the new jurisdiction to avoid becoming unperfected. See former Section 9-103(1)(d). Likewise, if the debtor moved to a new jurisdiction, secured parties with security interests in accounts, general intangibles, chattel paper (to the extent perfection depended on filing and not also on possession) and mobile goods (to the extent perfection did not instead depend on having a lien noted on a certificate of title or on some other method for perfection as with aircraft, ships and trains) had only four months to file in the new jurisdiction to avoid becoming unperfected. See former Section 9-103(3)(e). Certain of these changes have no effect under the rules of revised Article 9 (e.g., changes in location of non-real-estate-related collateral or changes in location of the chief executive office of a registered organization); but since they mattered under former Article 9 and since continued perfection under the transition rules of revised Article 9 may depend on the continued effectiveness of filings under the old rules, they need to be kept in mind during the transition period.

If your perfection and priority depend on your former Article 9 filing, and if a change in physical location of the collateral or of the debtor during the transition period would have had the effect described in the previous paragraph of causing that former Article 9 filing to cease to be effective, you may need to take action quickly. If you are now perfected in the appropriate filing office under revised Article 9 (e.g., your former Article 9 filing happens to be in the correct place to be on file under revised Article 9, or you have already continued your former Article 9 filing by filing in the correct revised Article 9 filing office using the "in lieu" method), you need do nothing. *However, if you are not now on file in the appropriate revised Article 9 filing*

office, you should continue your former Article 9 filing in the appropriate filing office under revised Article 9 as soon as you learn of the change in physical location. This must be done before the change has occurred, if possible, or, next best, within four months after the change has occurred — by an “in lieu” continuation of the former Article 9 filing in the correct revised Article 9 filing office.

By way of example, assume you had properly perfected your security interest in a piece of equipment located in New Jersey by filing a financing statement in New Jersey in 1999 (prior to the effective date of revised Article 9). On March 1, 2004, your debtor, a Delaware corporation, moves that piece of equipment into New York. Even though

revised Article 9’s transition rules generally permit you to leave your former Article 9 filings in place until they are scheduled to lapse, your New Jersey filing may cease to be effective to perfect your interest in the equipment, either immediately or on July 1, 2004, four months after the equipment was moved. In order to maintain perfection, you should do an “in lieu” continuation in Delaware, either before the change in physical location, if possible, or during the four-month period thereafter.

The precise rules in this context are not, unfortunately, made clear in revised Article 9. Some people have expressed the opinion that perfection premised only on a former Article 9 filing that is not in the correct revised Article 9 office ceases immediately upon such a change in physical location; others (perhaps a majority of those who have considered the issue) believe that former Article 9’s four-month grace period to file in the correct office should continue to apply; still others think that the former Article 9 filing should remain effective to perfect until it lapses, regardless of the change in physical location. In view of this uncertainty, the safest course of action is to file in the correct revised Article 9 filing office as soon as you learn of the change, whether prospectively or after the fact. This problem could be solved if it were possible immediately to continue every filing in your portfolio that can be continued using the “in lieu” method; however, that may well be impractical for large portfolios. Nevertheless, it would be

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good policy to make sure that you are on file in the correct revised Article 9 filing office with respect to each deal that you have occasion to review for any reason, particularly for “problem” accounts. (Another reason for filing any applicable “in lieu” continuations related to troubled deals is that other secured creditors seeking to foreclose on your collateral are required to search only in the correct revised Article 9 filing office before sending the mandated foreclosure notices.)

Of course, if a change in physical location of the debtor also involves a change in location under revised Article 9, you should protect the perfection and priority of your security interest by following the advice given earlier.

Analyzing the significance of changes in both revised Article 9 location and former Article 9 location is complicated enough

that you may want to consult with your attorney to determine what, if any, action you need to take following such changes. ▲

The author would like to acknowledge helpful conversations with and comments from Donald J. Rapson, Edwin E. Smith, and Steven L. Harris during the preparation of this article. Understanding of these issues was greatly assisted by reading comments written by Steven O. Weise on a UCC listserv (UCCLaw-L@lists.washlaw.edu) and the following two articles: Steven O. Weise and Susan R. Goldfarb, *My Dog Ate My Perfection — What Can Go Wrong Post-Closing*, 35 UCCLJ 1 (2003) and Edwin E. Smith, *The Resolution of “Double Debtor” Issues Under Revised UCC Article 9*, Commercial Law Newsletter of the Business Law Section of the American Bar Association (December 2001). Opinions expressed herein, as well as any errors, are attributable solely to the author.



Robert W. Ihne is vice president and associate chief counsel for CIT Group Inc., Livingston, NJ. He has worked in CIT’s Legal Department since January of 1987.