How to Maintain Perfection and Priority When Changes Occur After Closing – Revised Following the 2010 Amendments to Article 9

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The revisions to Article 9 promulgated in 1998 became effective in all fifty states, the District of Columbia and Puerto Rico in 2001 or 2002. Article 9 has since been modified in certain respects by amendments approved in 2010 (the 2010 Amendments) that, as of September 2013, have become effective in forty-four states, the District of Columbia and Puerto Rico, and have been introduced for enactment in the other six states (Alabama, Arizona, California, New York, Oklahoma and Vermont). This article concerns one of the most difficult subjects under Article 9 that 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 original debtor into another debtor, and an assumption by a different debtor of the original debtor's obligations.

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 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 such continuation is necessary because obligations secured by the collateral will extend beyond the lapse date) in order to 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.

Change in Debtor's Location

Under Article 9, the place to file with respect to most collateral is the debtor's location. The term “location” has a special meaning under 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 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 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.

Prior to the 2010 Amendments, the story was different for collateral acquired by the debtor after a change in location, where your perfection and priority extended only from the date that you filed in the new location: you did not become perfected on collateral acquired by the debtor at any time after the move without filing in the new location. Now, however, where the relevant jurisdictions have the 2010 Amendments in effect, new Subsection 9-316(h) provides that you will also be perfected in, and retain priority as to, collateral acquired by the debtor within four months after the change in location. Analogous to the four month grace period provided with respect to a name change discussed above, you must file in the new jurisdiction within the four month period to remain perfected and prior in collateral acquired by the debtor following that four month period. 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 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 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, filing against the buyer 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 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 or 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 (pre-2001) 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 Article 9 regarding perfection and priority are the same as for the sale to a buyer not in ordinary course of business discussed in the “Sales of Existing Collateral” section 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 in (b) 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 (b) 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 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 and such security interest is perfected under certain circumstances. See Sections 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) and 9-508(a) (except with respect to a material change in name or a difference in location, a filing against the original debtor remains effective to perfect in the collateral of the new debtor – even as to after-acquired collateral).

To maintain perfection in such after-acquired collateral of the new debtor, however, you may need to take further action. First of all, 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 Section 9-508(b).

Secondly, if the new debtor is located in a different jurisdiction than the original debtor, you will need to file a financing statement against the new debtor in that jurisdiction. Prior to the 2010 Amendments becoming effective in states that have enacted them, you would not have been perfected in any collateral acquired by the new debtor after it became bound until you filed in that other jurisdiction. Where the relevant jurisdictions have the 2010 Amendments in effect, new Subsection 9-316(i) provides that you will also be perfected in collateral acquired by the new debtor within four months after it became bound. This new provision gives you a four month grace period to file against the new debtor in its location to remain perfected in all after-acquired collateral under your security agreement.

With respect to the situation described in the previous paragraph where the new debtor is located differently than the original debtor, if your new filing in the new location 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 where the new debtor is in the same location but has a materially different name, 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 former situation, 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)) – and therefore there would be no point to continuing it – in the latter situation 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) (stating that 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.

Where the 2010 Amendments Have Not Yet Been Enacted

The 2010 Amendments were drafted to become effective on July 1, 2013. Unfortunately, as of September 2013, there are still six states that have only introduced, but not enacted, them: Alabama, Arizona, California, New York, Oklahoma and Vermont. The provisions of these 2010 Amendments, which are the concern of this article, are the two new four month grace periods with respect to perfecting in the after-acquired collateral of (i) a debtor whose location has changed and (ii) a new debtor located in a different jurisdiction. Until the 2010 Amendments become effective in these states, if your debtor has relocated to one of them or a new debtor located in one of them has become bound by your security agreement, you will not have the benefit of that four month grace period.

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