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Richard F. Duncan

University of Nebraska College of Law, rduncan2@unl.edu

William H. Lyons

University of Nebraska College of Law, wlyons2@unl.edu

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Perfection of Security Interests Under Article 9: Changed Circumstances and the Duty to Refile within a Given State

Apart from death and taxes, perhaps the only certainty upon which we can rely in this fickle world is change. Things change, inevitably and ubiquitously.¹

So it is with the facts and circumstances which shape and inform a financing statement that has been filed to perfect an Article 9 security interest. The debtor's residence or place of business, or even his or her name, may change. The collateral may be moved or its use may evolve.

What happens when such changes occur in a state such as Nebraska that requires local filing to perfect certain security interests?² Is a secured party who has perfected by filing required to monitor its debtor and the collateral to ensure that the filed financing statement does not become misleading? Or must subsequent creditors searching

* Professor of Law, University of Nebraska College of Law. Professor Duncan is a Visiting Professor of Law at Notre Dame Law School during the 1985-86 academic year.

** Assistant Professor of Law, University of Nebraska College of Law.
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1. In 1859, Abraham Lincoln made the same point in a speech in Wisconsin: "It is said an Eastern monarch once charged his wise men to invent him a sentence, to be ever in view, and which should be true and appropriate in all times and situations. They presented him the words: 'And this, too, shall pass away.'" A. Lincoln, Address Before the Wisconsin State Agricultural Society, Milwaukee, Wis., Sept. 30, 1859, *quoted in* G. WILL, STATECRAFT AS SOULCRAFT: WHAT GOVERNMENT DOES 18-19 (1983).

2. In this context, local filing means filing with county or municipal officials in lieu of or in addition to filing with one central office, such as the secretary of state.

the U.C.C. files bear the risk of misleading changes? The 1972 Official Text of Article 9 strikes what amounts to a rough compromise.

I. SECTION 9-401(3)

In a typical secured transaction, once counsel for the secured party has determined the proper state in which to file a financing statement,³ he or she must then determine where to file within the relevant state.⁴ The answer to this last question will usually turn on one or more of the following factors: the location of the debtor's residence or place of business, the location of the collateral, or the debtor's use of the collateral.⁵

Suppose, for example, that the *SP* makes a loan to *D*, a resident of County *A*, and acquires a security interest in the snow blower that *D* uses to clear his driveway and sidewalk during the winter. *SP* perfects its security interest in this item of consumer goods⁶ by filing locally in County *A*.⁷ Thus, the two facts that control this filing in County *A* are the debtor's residence in County *A* and his use of the collateral for consumer purposes.⁸

Now suppose that *D* subsequently moves to County *B*. Will the County *A* filing continue to be effective? Or suppose that *D* establishes a snow removal service and uses the blower in the business. Will this change in the use of the collateral necessitate a new filing in the office of the Secretary of State?⁹ Both questions are answered by U.C.C. Section 9-401(3). There are two versions of Section 9-401(3), the standard version, which has been adopted in most jurisdictions, and the alternative version, which has been adopted in only a few jurisdictions. Under the standard version of 9-401(3), neither *D*'s change of residence nor the change in the use of the collateral affect the original filing in County *A*.¹⁰

3. See U.C.C. § 9-103 (1972).

4. See *id.* at § 9-401(1).

5. See *id.*

6. See *id.* at § 9-109(1).

7. See *id.* at § 9-401(1)(a) (Second Alternative Subsection (1)) (the proper place to file a financing statement when the collateral is consumer goods is in a specified public office "in the county of the debtor's residence"). Nebraska has adopted a nonuniform version of Second Alternative Subsection (1)(a). See Nebraska U.C.C. § 9-401(1)(a) (Supp. 1985). The nonuniform language would not, however, change the place of filing noted in the hypothetical.

8. See *supra* note 7.

9. See U.C.C. § 9-401(1)(c) (Second Alternative Subsection (1)), (requiring a central filing to perfect security interests in business equipment).

10. Section 9-401(3) of the Code provides: "A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed."

Nebraska currently has a nonuniform version of Section 9-401(3). Although

Likewise, under the alternative version of 9-401(3), the change in use of the collateral does not impair the effectiveness of the original filing.¹¹ Changes in the location of the debtor's residence or place of business, or in the location of the collateral, however, are treated differently under the alternative subsection, which provides in pertinent part:

A filing which is made in the proper county continues effective for four months after a change to another county of the debtor's residence or place of business or the location of the collateral, whichever controlled the original filing. It becomes ineffective thereafter unless a copy of the financing statement signed by the secured party is filed in the new county within said period. The security interest may also be perfected in the new county after the expiration of the four-month period; in such case perfection dates from the time of perfection in the new county.¹²

This provision is an attempt to balance the interests of the original filer against those of subsequent credit searchers. It gives the original filer a four-month grace period to learn of the change and to refile in the appropriate county. Thus, in our hypothetical involving *D*'s relocation to County *B*, *SP* is required to refile in County *B* within the four-month period in order to ensure continuous perfection of its security interest.

II. SECTION 9-401(7)

Now suppose that in 1983 debtor, Balboa Gun Company, borrows \$100,000 from First Bank and grants First Bank a security interest in all of its present and after-acquired inventory and equipment. First Bank promptly perfects its security interest by filing a financing statement against the debtor in the proper public office. Next, on January 1, 1985, debtor changes its name to "Rambo Firearms, Inc.," and on June 1, 1985, borrows \$100,000 from Second Bank secured by the same types of collateral. Second Bank immediately perfects its security interest by filing a financing statement in the proper public office. Prior

that Section as originally adopted in Nebraska was uniform, in 1985 the legislature added the following nonuniform language at the end of Section 9-401(3): "A debtor's residence is presumed to be the residence shown on the filing. The showing of an improper residence shall not affect the validity of the filing or the perfection of such filing." 1985 Neb. Laws 606 § 2, codified at Nebraska U.C.C. § 9-401(3) (Supp. 1985). While the nonuniform language would not appear to change the result in the textual hypothetical, this nonuniform language is at best unclear and perhaps self-contradictory. No other state has adopted similar language. See 3A U.L.A. 14 (1981 & 1986 Supp.). The authors believe that states that have adopted Article 9 should strive for uniformity unless compelling local interests require nonuniform language. The nonuniform language added to Nebraska U.C.C. § 9-401(3) serves no apparent purpose, compelling or otherwise, and should be repealed.

11. U.C.C. § 9-401(3) (Alternative Subsection (3)).

12. *Id.* Alternative Subsection (3) has been adopted in only a few states. See 3A U.L.A. 14 (1981 & 1986 Supp.).

to making the June 1 loan to debtor, Second Bank searched the U.C.C. files under the name "Rambo Firearms, Inc." and found no adverse filings. Finally, debtor defaults on both loans in March of 1986. What result under Article 9?¹³

U.C.C. Section 9-402(7), a provision added by the 1972 amendments, cuts a rough compromise—First Bank has a prior perfected security interest in all of the collateral acquired by the debtor before the name change plus all of the collateral acquired within four months thereafter; however, Second Bank has the only perfected claim against collateral acquired by the debtor more than four months after the change.¹⁴ As one commentator has observed, the practical effect of 9-402(7) is to give First Bank a prior claim against most of the debtor's equipment and Second Bank a prior claim against most, if not all, of the debtor's inventory.¹⁵ This observation assumes that most of the debtor's inventory (but not its equipment) will turn over in the ordinary course of the debtor's business during the period following the name change. Therefore, the inventory on hand in March 1986 will be "collateral acquired by the debtor more than four months after the [name] change" and, as such, First Bank's security interest in this inventory is unperfected.¹⁶

It is important to understand that Section 9-402(7) does not affect First Bank's security interest in collateral acquired by the debtor before expiration of the four-month period following the name change. As to this collateral, First Bank has a continuous secret lien that, although physically in the files, is hidden from all but the most diligent persons searching the U.C.C. records.¹⁷ This result contradicts the goals of the concept of notice filing upon which Article 9 has

13. See generally Westbrook, *Glitch: Section 9-402(7) and the U.C.C. Revision Process*, 52 GEO. WASH. L. REV. 408 (1984). For a list of cases construing Section 9-402(7), see *id.* at 411 n.17. The cases are also collected in Annot., 99 A.L.R.3d 1194 (1980).

14. U.C.C. § 9-402(7) (1972) provides in pertinent part:

Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time.

Section 9-402(7) also applies "when mergers or other changes of corporate structure of the debtor occur with the result that a filed financing statement might become seriously misleading." *Id.* at § 9-402(7) comment 7. See, e.g., *In re West Coast Food Sales, Inc.*, 637 F.2d 707 (9th Cir. 1981) (incorporation of proprietorship).

15. Westbrook, *supra* note 13, at 409.

16. *Id.* at 409 n.6.

17. See *id.* at 412. Of course, if Second Bank had been more diligent, it would have discovered the name change and searched under the debtor's original name.

been constructed. Section 9-402(7) should be amended in any future revision of Article 9.¹⁸

18. Professor Westbrook has suggested that § 9-402(7) should be amended to require secured creditors to file a new financing statement under the new name within some reasonable period of time after the name change. *Id.* at 414. The authors endorse this proposal.