Assignment 16
Post-Transaction Changes II: Sale; Change of Use; Name Changes; Reorganization of Debtor’s Legal Structure

Changes and Ostensible Ownership

- A filed UCC-1 is “static,” but facts often change
  - E.g., Bank has perfected SI in Debtor’s tractor
  - In a later transaction, Debtor swaps the tractor for a golf cart (which is “proceeds” covered by Bank’s SI)
  - Problem: If Bank’s UCC-1 describes “tractor,” a third party dealing with Debtor may not realize that Bank has SI in the golf cart
- When such changes occur, what (if anything) must secured party do to fix this problem?

Problem 1

- Bank has perfected SI in all equipment and furnishings of Sarah Jones (lawyer), perfected by filed UCC-1
- Jones sells all of the collateral to Andrew Smith (who is taking over Jones’s practice)
  - Smith plans to take over payments Jones owes to Bank
- After the sale, Smith is now the “debtor” (the owner of the collateral)
- Does Bank have to file a new UCC-1 under “Andrew Smith” to remain perfected?

A. Yes, w/in 4 months following the sale
B. Yes, w/in 1 year following the sale
C. No

Possible Approaches

- Post-transaction change that renders UCC-1 misleading results in immediate loss of perfection (rejected by Art. 9 drafters)
- Grace period of temporary perfection; secured party must “cure” problem during grace period to maintain continuous perfection
- Secured party’s continuous perfection is unaffected by change (searcher bears risk)

(a) [Disposition.] A filed financing statement remains effective with respect to collateral that is sold, exchanged, licensed, or otherwise disposed of and in which a security interest ... continues, even if the secured party knows of or consents to the disposition.

(b) [Information becoming seriously misleading.] Except as otherwise provided in subsection (c) ..., a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under Section 9-506.

Sale of Collateral

- Unless Bank authorized sale free of its SI:
  - Bank’s SI continues in collateral [§ 9-315(a)(1)]
  - Bank’s filed UCC-1 vs. collateral remains effective to perfect that SI [§ 9-507(a)]
- 3rd parties dealing w/Andrew Smith now face an ostensible ownership problem (no filing vs. “Andrew Smith” covering the equipment)
  - But, Bank does NOT have to “fix” it (i.e., file a new UCC-1) to keep its SI perfected!

Perfection After Sale [§ 9-507(a), (b)]

- What would a 3rd party dealing w/Andrew Smith (a possible buyer or secured party) have to do to protect against the risk posed by §§ 9-507(a), (b)?
  - Reconstruct “chain of title” for the equipment (all previous owners), and must search for filings against each prior owner
  - Search vs. “Sarah Jones” would have revealed Bank’s filed UCC-1 covering the equipment/office furniture

Problem 2

- CCC (car dealer) sells a Bentley to Crouch on an installment K, retaining PMSI to secure price
  - CCC has SI noted on car’s title certificate (COT)
  - CCC assigns Crouch’s contract to First Bank
  - First Bank gets possession of COT, but it does not apply to Dept. of Revenue to have its status as the secured party noted on the COT
- Is First Bank’s SI in the car still perfected?
  A. Yes
  B. No
§ 9-310(c) [Assignment of perfected security interest.]
If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

§ 9-311(b) [Compliance with other law.] Compliance with the requirements of [the certificate of title act] for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article....

Assignment of SI: Rationale
- Even if the Assignee (First Bank) doesn’t have its assignment noted on COT for the car, this doesn’t prevent 3rd parties dealing with Crouch from obtaining relevant information (notice function has been fulfilled)
  - COT for the car shows lien in favor of CCC
  - Inquiry of CCC would reveal that CCC had assigned its rights under the Crouch contract (and thus its SI in the Bentley) to First Bank

Problem 2: Assignment of SI
- First Bank’s SI in the car is properly perfected by notation of CCC’s lien on COT
  - For titled goods, notation on COT = filing of UCC-1 [§ 9-311(b)]
  - When perfected SI is assigned, assignee can amend UCC-1 to reflect assignment, but is not obligated to do so
- SI in car remains perfected vs. creditors of Crouch and buyers from Crouch [§ 9-310(c)]

Problem 2
- Is there any good reason for Bank to have the assignment of the lien noted on the COT for the Bentley, if § 9-310(c) doesn’t require it?
  - If CCC is listed as lienholder on COT, CCC has power to release that lien (and to enable Crouch to get “clean” COT)
  - Having itself noted as assignee on COT would mean that only Bank could then release the lien
Problem 3

- CCC also sold a used Ferrari to Bowman on installment K (CCC retained PMSI)
  - CCC sold the Bowman contract to First Bank
  - CCC’s lien was properly noted on title certificate
- Bowman later sold Ferrari to Crouch
  - Crouch bribed DMV to issue a “clean” title
- Does First Bank still have a perfected SI in the Ferrari, or does Crouch own it free/clear?

- § 9-311(b): SI perfected by compliance with COT statute “remains perfected notwithstanding … transfer of possession of the collateral”
  - Crouch’s thus takes car subject to First Bank’s perfected SI
  - Cf. § 9-513(d): termination statement only terminates effectiveness of UCC-1 if it is “authorized” [§ 9-510(a)]

Problem 4

- ACF has a perfected SI in “all inventory” of Farm Pride Lawn & Garden
- Farm Pride’s owner, Abrams, took a riding mower out of his inventory and is using it at home
  - Problem: ACF’s UCC-1 does not cover “consumer goods”
- Does ACF have to amend its UCC-1 to stay perfected as to the riding mower?


(a) [Disposition.] A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest ... continues, even if the secured party knows of or consents to the disposition.

(b) [Information becoming seriously misleading.] Except as otherwise provided in subsection (c) ..., a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under Section 9-506.
Problem 4: Use Change

- Change ⇒ ostensible ownership problem
  - To 3rd party, mower now appears to be “consumer goods” rather than “inventory”
  - UCC-1 description (“inventory”) may mislead searchers
- But, filed UCC-1 remains effective, so ACF’s SI is still perfected [§ 9-507(b)] (no obligation on ACF to “correct” the UCC-1)

Problem 5: Debtor Name Change

- 2011: Bank made a loan to Fred Farmer, took SI in Fred Farmer’s present/after-acquired farm equipment (perfected by filing)
- January 2013: Fred Farmer legally changes his name to James Davis
- September 2014: Davis filed bankruptcy petition
- October 2014: Bank learns of name change only when it receives a notice of Davis’s bankruptcy petition (no new UCC-1 filing vs. “James Davis”)


(c) [Change in debtor’s name.] If the name that a filed financing statement provides for a debtor becomes insufficient as the name of the debtor under Section 9-503(a) so that the financing statement becomes seriously misleading under Section 9-506:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the filed financing statement becomes seriously misleading; and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the filed financing statement becomes seriously misleading, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the financing statement became seriously misleading.

- Davis has 20 pieces of farm equipment
  - Pieces 1-17: acquired prior to 2011
  - Piece 18: acquired in November 2012 (when he was still “Fred Farmer”)
  - Piece 19: acquired in February 2013 (name change in January 2014)
  - Piece 20: acquired in August 2014
- As of petition date, Bank had not amended its UCC-1 to reflect Fred’s name change
- As to which pieces of equipment does Bank still have a perfected SI?
Problem 5: Name Changes

- Change creates ostensible ownership problem; 3rd parties searching under “James Davis” won’t find UCC-1 filed under prior name “Fred Farmer”
- But for items 1-18 (acquired by Debtor before name change to “James Davis”), Bank need not amend its UCC-1, which is still effective [§ 9-507(c)(1)]
  - Burden is on 3rd parties dealing with Davis to identify any names Davis may have used during the past 5 years (e.g., Fred Farmer), and to search for UCC filings under those names, too

Name Changes and After-Acquired Collateral: Rationale?

- If secured party already has a SI in an item at the time Debtor changes his/her name, secured party shouldn’t have to monitor name to maintain its perfected status
- But, if secured party’s SI extends to property acquired by debtor under its “new” name (“James Davis”), secured party should have some burden to monitor debtor’s name and correct a UCC-1 that has become “seriously misleading” as a result of the change

Name Changes and “After-Acquired”

- Change rendered Bank’s UCC-1 “seriously misleading” and no new filing was made
  - Bank still has a perfected SI in item #19 (which was acquired by Davis during first first 4 months after name change), **BUT**
  - Bank’s SI in item #20 (acquired by Davis more than 4 months after name change), is *unperfected by original UCC-1*

Problem 5

- How can Bank protect vs. this risk?
  - Monitoring for changes in Debtor’s name at least every 3-4 months (i.e., does name on checks received for payment “match” name on loan documents?)
  - If Bank discovers name change, it can amend its initial UCC-1 to reflect name change
  - Security agreement can make it a default for Debtor to change its name w/out prior consent
Debtor’s Name Change

• What if Fred Farmer legally changed his name to James Davis, but he never got his drivers’ license changed, and his license still says “Fred Farmer”?


  (c) [Change in debtor’s name.] If the name that a filed financing statement provides for a debtor becomes insufficient as the name of the debtor under Section 9-503(a) so that the financing statement becomes seriously misleading under Section 9-506:

  (1) the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the filed financing statement becomes seriously misleading; and

  (2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the filed financing statement becomes seriously misleading, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the financing statement became seriously misleading.

Problem 6

• 2013: Bank extended line of credit to Tanya Turner, who operated the business “Tanya’s Treats” as a sole proprietorship
  – Bank took and properly perfected (by filing) a SI in “all of the debtor’s inventory, equipment and accounts (including after-acquired)”
• Summer 2014: Tanya reorganized her business as Tanya’s Treats, LLC
• What is the effect of this reorganization on Bank’s security interest in the collateral?
• Before Tanya organized the business as an LLC, the business did not have a separate legal identity, separate from her as an individual
• Therefore:
  – Tanya (as an individual) owned all the assets and liabilities of the business
  – Thus, Bank’s security agreement would have to be authenticated by her as an individual, and UCC-1 would have to be filed in using her individual legal name
  – This would be true even if she “held her business out” as “Tanya’s Treats”

• After she organizes the business as an LLC, Tanya Turner and Tanya’s Treats, LLC are distinct legal “persons” (not a “name change”)
• Thus, Tanya effectively transferred the assets of the business from herself (as sole proprietor) to Tanya’s Treats, LLC
  – Bank had a perfected SI in all inventory, equipment, and accounts of Turner as proprietor
  – Tanya’s Treats, LLC took them subject to Bank’s perfected SI; no amendment to UCC-1 was needed to maintain Bank’s perfected status [§§ 9-507(a)]

Problem 6

• Problem: after reorganizing, Tanya’s Treats, LLC has been acquiring/making new inventory and generating new accounts
• Are these new items covered by the after-acquired clause in Bank’s security agreement?
  – Problem: Tanya’s Treats, LLC (the current “debtor”) didn’t sign the security agreement; Tanya Turner did!

§ 9-203. Attachment and Enforceability of Security Interest. . . .

  (d) [When person becomes bound by another person’s security agreement.] A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:
  
  (1) the security agreement becomes effective to create a security interest in the person’s property; or
  
  (2) the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.
§ 9-203. Attachment and Enforceability of Security Interest. . . .

(e) [Effect of new debtor becoming bound.] If a new debtor becomes bound as debtor by a security agreement entered into by another person:

1) the agreement satisfies [Section 9-203(b)(3)] with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement, and

2) another agreement is not necessary to make a security interest in the property enforceable.

§ 9-102(a)(56). “New debtor” means a person that becomes bound as debtor under Section 9-203(d) by a security agreement previously entered into by another person.

School of Law

Problem 6: Is Tanya’s Treats, LLC a “New Debtor”?

• Tanya’s Treats, LLC is a “new debtor” if
  – It expressly assumed Tanya Turner’s specific obligations under the security agreement [§ 9-203(d)(1)], or
  – It generally assumed all of Turner’s liabilities and acquired all of her assets [§ 9-203(d)(2)]

School of Law

• If Tanya’s Treats, LLC is a “new debtor,” then Bank has a SI in the new inventory and accounts of Tanya’s Treats, LLC
  – As a “new debtor,” the LLC is bound by the after-acquired property clause in Turner’s original security agreement [§ 9-203(e)(1)]

• If not, Bank has no SI in the inventory and accounts produced by Tanya’s Treats, LLC after its reorganization, unless the LLC enters into a new security agreement with Bank (or ratifies the existing one)

School of Law

Problem 6 (Level 2: Perfection)

• Even if Tanya’s Treats, LLC is a “new debtor,” Bank still has a problem
  – Tanya’s Treats, LLC is the “new debtor,” so the initial UCC-1 (filed under “Tanya Turner”) is almost certainly now “seriously misleading”
  – Bank has 4 months after LLC organizes to file a new initial UCC-1 in name of Tanya’s Treats, LLC (comparable to name change rule) [§ 9-508(b)]
Problem 6 (Level 2: Perfection)

- Suppose LLC organization occurred June 1, 2014
- As of November 1, 2014, Bank has not filed a new UCC-1 vs. “Tanya’s Treats, LLC.” Result:
  - Bank has a perfected SI in inventory or accounts acquired/arising during June-September (4 months), but
  - Bank’s SI in inventory or accounts acquired or arising after October 1 is unperfected