REVISIONS CONCERNING POST-CLOSING EVENTS (INCLUDING THE "DOUBLE DEBTOR" PROBLEM)

Reporters' Prefatory Note to Draft

The following draft provisions address a set of problems on which the Study Committee spent a considerable (inordinate, perhaps) amount of time. They are considered in Section 17 of the Study Committee Report. We encourage you to study that portion of the Report as you review the following. The Reporters' Explanatory Notes explain the operation of the draft statutory text, but for the most part do not explore the merits of the issues raised. We have relied on the Report for that discussion.

§ 9-312. Priorities Among Conflicting Security Interests in the Same Collateral.

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(v) Where a debtor acquires property subject to a security interest created by another person:

(a) if the security interest is perfected at the time the debtor acquires the property, any security interest created by the debtor is subordinate to the other security interest notwithstanding anything to the contrary in this Section, provided that there is no period thereafter when the other security interest is unperfected; and

(b) if the security interest is unperfected at the time the debtor acquires the property or there is a period thereafter when the other security interest is unperfected, the other applicable subsections of this Section govern.

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Reporters' Explanatory Notes

1. Draft subsection (v) responds to Study Committee Recommendation 17.H (Report, at 149-51). It addresses the "double debtor" problem created when a debtor acquires property that is subject to a security interest created by another debtor. In the simplest example, A sells an item of its equipment to B, not in the ordinary course of business. The equipment is subject to a security interest in favor of SP-A. If SP-A's security interest is perfected, B will acquire its interest subject to SP-A's security interest. See §§ 9-201; 9-301(1)(c). Under draft subsection (v)(a), if B creates a security interest in the equipment in favor of SP-B, SP-B's interest also is subject to SP-A's interest, even if SP-B filed against B before SP-A filed against A, and even if SP-B took a purchase money security interest. This result is premised on the belief that SP-B could have investigated the source of the equipment and discovered SP-A's filing before making an advance against the equipment, whereas SP-A had no reason to search the filings against someone other than its debtor, A.

2. If SP-A's security interest is unperfected, B will take free of it as long as B gives value and takes delivery of the equipment without knowledge of the security interest. See § 9-301(1)(c). If B takes free of SP-A's security interest and then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment. Suppose, however, that B knows of SP-A's security interest and therefore takes the equipment subject to it. If B creates a security interest in the equipment in favor of SP-B and SP-B perfects its security interest, then under draft subsection (v)(b) the priority rules of § 9-312 other than subsection (v) govern. Under § 9-312(5)(a), SP-A's unperfected security interest will be junior to SP-B's perfected security interest. The award of priority to SP-B is premised on the belief that SP-A's failure to file could have misled SP-B.

3. If SP-A's interest is perfected when B acquires the equipment but for some reason SP-A's security interest later becomes unperfected, under draft subsection (v)(b) the priority rules of § 9-312 other than subsection (v) govern. For example, if SP-A's financing statement were to lapse and SP-B's security interest were perfected, SP-B's security interest then would become senior to SP-A's security interest. See §§ 9-312(5)(a); 9-403(1).

§ 9-402. Formal Requisites of Financing Statement; Amendments; Mortgage as Financing Statement.

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(2) A financing statement ~~which~~ that otherwise complies with subsection (1) is sufficient when it is signed by the secured party instead of the debtor if it is filed to perfect a security interest in:

* * *

(c) collateral as to which the filing has lapsed~~; or~~

~~(d) collateral acquired after a change of name, identity or corporate structure of the debtor (subsection (7))~~.

(4) A financing statement may be amended by filing a writing signed by both the debtor and the secured party, but an amendment to the debtor's name is sufficient without the debtor's signature. An amendment does not extend the period of effectiveness of a financing statement. If any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. In this Article, unless the context otherwise requires, the term "financing statement" means the original financing statement and any amendments.

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(7) A financing statement sufficiently shows the name of the debtor only if it gives the individual, partnership, or corporate name of the debtor~~, whether or not it adds other trade names or names of partners~~. A financing statement that sufficiently shows the name of the debtor is not rendered ineffective by the addition or absence of trade or other names or names of partners.

(8) Where the debtor so changes ~~his~~ its name ~~or in the case of an organization its name, identity or corporate structure~~ that a filed financing statement becomes seriously misleading~~,~~:

(a) the financing statement remains effective to perfect a security interest in collateral acquired by the debtor within four months after the change, and

(b) the financing statement ~~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~~ an amendment to the financing statement that renders the financing statement not seriously misleading is filed before the expiration of that time.

(9) A filed financing statement remains effective with respect to collateral ~~transferred by the debtor~~ that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest continues under Section 9-306(2), even though the secured party knows of or consents to the transfer.

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Reporters' Explanatory Notes

1. The revisions to draft subsection (7) respond to Study Committee Recommendation 17.A (Report, at 39-40). They reflect the prevailing view that the "individual, partnership or corporate name of the debtor" on a financing statement is both necessary and sufficient, whether or not trade or other names are included. Recommendation 17.A also calls for expanded official comments that address the names of individuals and entities other than corporations or partnerships.

2. Subsection (8) responds to Study Committee Recommendations 17.B and 17.C (Report, at 140-42). It addresses a "pure" change of name that does not implicate a new debtor. It clarifies the effectiveness of a seriously misleading financing statement for the four months following a name change and provides that the record can be corrected by an amendment to the financing statement that specifies the debtor's new correct name. The amendment is effective if signed only by the secured party pursuant to draft subsection (4).

3. Subsection (9) clarifies the third sentence of current § 9-402(7), as proposed in Recommendation 17.G (Report, at 149), by providing that a financing statement remains effective following the transfer of collateral only when the security interest continues in that collateral. This result is consistent with the conclusion of PEB Commentary No. 3.

§ 9-402A. Effectiveness of Financing Statement When New Debtor Becomes Bound by Security Agreement.

[First Alternative]

(a) In this section:

(1) "new debtor" means a person who becomes bound by a security agreement [signed] [entered into] by another person; and

(2) "original debtor" means the person who [signed] [entered into] the security agreement to which the new debtor has become bound.

(b) A filed financing statement naming the original debtor is not effective to perfect a security interest in collateral in which the new debtor has or acquires rights; however, this section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under Section 9-402(9).

[Second Alternative]

(a) In this section:

(1) "new debtor" means a person who becomes bound by a security agreement [signed] [entered into] by another person [if the person becomes bound in connection with a transaction or series of transactions pursuant to which the person who becomes bound continues to operate the business or a portion of the business previously operated by the other person]; and

(2) "original debtor" means the person who [signed] [entered into] the security agreement to which the new debtor has become bound.

(b) This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under Section 9-402(9).

(c) [At the time when the new debtor becomes bound by the security agreement, a] [A] filed financing statement naming the original debtor [becomes] [is] effective to perfect a security interest in collateral that is described in the security agreement and covered by the financing statement and in which the new debtor has or acquires rights.

(d) If a filed financing statement that [becomes] [is] effective under subsection (c) is seriously misleading with respect to the name of the new debtor:

(1) the filing [remains] [is] effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound, and

(2) the filing is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound unless an amendment to the financing statement that renders the financing statement not seriously misleading is filed before the expiration of that time.

Reporters' Explanatory Notes

1. Draft § 9-402A reflects Study Committee Recommendations 17.E and F. It deals with the situation where one party (B) becomes bound by another party's (A's) security agreement (including any after-acquired property clause) in favor of SP-A. The First Alternative reflects the views of some members of the Study Committee (described as "View A" in the discussion of Recommendation 17.E). Subsection (b) of the First Alternative provides that the filing against A is not effective to perfect SP-A's security interest in B's property. (Note, however, that this section does not apply to collateral transferred by A to B, as to which the filing against A does continue to be effective under draft § 9-402(9).)

2. The Second Alternative reflects "View B." It provides, in subsection (c), that SP-A's filing against A is effective to perfect SP-A's security interest in collateral that B acquires before the expiration of four months after B becomes bound by the security agreement. Under subsection (d), however, if SP-A's filing against A is seriously misleading as to B's name, SP-A's filing is effective as to collateral acquired by B after the four-month period only if SP-A files during the four-month period an amendment rendering the filing not seriously misleading. See Note 6, below.

3. Tennessee recently amended its § 9-402(7) (effective July 8, 1994) to add a form of "safe harbor" for certain narrowly-defined situations in which the name of the new debtor is very much like the name of the old debtor:

> A financing statement shall not be deemed seriously misleading for purposes of [§ 9-402] by the merger, consolidation, share exchange or conversion of a debtor from one type of entity (e.g., corporation, partnership, limited partnership, limited liability company) into another and a corresponding change in the debtor's name, providing the debtor's name changes only to

> the extent of adding or changing the designation of the debtor's form of organization.

Implicit in this amendment is that the financing statement signed by the old debtor remains effective against the new debtor, even if the new debtor did not sign it. An accompanying amendment to Tennessee's § 9-203, set forth in the following Note, addresses whether the new debtor is bound by the old debtor's security agreement even if the new debtor does not sign it.

4. As proposed in Recommendation 17.D, the official comments should be revised to explain that non-UCC law, and not Article 9, governs the circumstances by which a new debtor becomes bound by the original debtor's security agreement. For example, the issue might be governed by the corporate law of mergers, as when A merges into B, or by contract law, as when B contractually assumes A's obligations under the security agreement.

Tennessee's § 9-203(5) (effective July 8, 1994) presents a somewhat different approach to the issue:

> (5) For the purposes of [§ 9-203(a)(1)], a security agreement signed by a debtor that subsequently undergoes a merger, consolidation, share exchange, conversion or other change in its identity or in the form of its organization shall also be deemed to have been signed by the person who, by operation of law or by agreement, succeeds to the debtor's rights and liabilities.

Some corporate laws provide that, when two corporations merge, the surviving corporation "has all the liabilities" of both. In the case where, for example, A Corp merges into B Corp (and A Corp ceases to exist), some people have questioned whether A Corp's grant of a security interest in its after-acquired property becomes a "liability" of B Corp, such that B Corp's after-acquired property becomes subject to a security interest in favor of A Corp's lender. The new Tennessee provision answers that question in the affirmative.

5. Adoption of the Second Alternative (View B) will necessitate a new priority rule to deal with the contest between SP-A and a secured creditor of B. Draft subsection (w), below, addresses this priority contest. Any such priority rule is likely to impose complexity and no doubt will be both under- and over-inclusive. Draft subsection (a)(1) of the Second Alternative contains bracketed language in the definition of "new debtor" that limits the term to debtors who become bound in transactions where they succeed to some or all of the original debtor's business. This would limit the circumstances in which SP-A's filing continues to be effective as to B's property during

the four-month period to those most likely to be sympathetic to SP-A--i.e., where there has been no apparent change in A's business.

6. If A ceases to exist as a result of the transaction under which B becomes bound, the amendment to be filed by SP-A pursuant to Second Alternative subsection (d)(2) presumably would change the name of the debtor on the financing statement from A to B. If A continues to exist and itself remains bound under the security agreement (as in A's sale of a division to B while continuing to operate other divisions), SP-A presumably would file an amendment that adds B as a debtor while retaining A as a debtor. If SP-A later became obligated to release or terminate the financing statement as to one but not both of the debtors, it could file an amendment deleting that particular debtor's name from the financing statement. That would solve the first problem raised in the Report, at 145, note 12. Concerning the second problem raised in that note, where A sells a division to B, B changes its name to A, and A changes its name to X, a properly drawn amendment also would provide a satisfactory solution. Once B changes it name to A, the original financing statement is not seriously misleading and SP-A need not file anything to preserve its perfected status as to B's (the new A's) property. As to A's name change, SP-A would file an amendment adding the debtor's new name "X" to the financing statement.

§ 9-312. Priorities Among Conflicting Security Interests in the Same Collateral.

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[First Alternative]

(w) The time when a new debtor (Section 9-402A) becomes bound by a security agreement [signed] [entered into] by an original debtor is the time of filing as to collateral for purposes of subsection (5).

[Second Alternative]

(w) A security interest that is perfected by a filed financing statement that is effective solely pursuant to subsections (c) and (d)(1) of Section 9-402A in collateral in which a new debtor (Section 9-402A) has or acquires rights is

subordinate to a security interest in the same collateral that is perfected in another manner.

Reporters' Explanatory Notes

1. Assume that B has become bound by a security agreement [signed] [entered into] by A in favor of SP-A. Assume also that B has created a security interest in favor of SP-B in collateral that also is covered by the SP-A security agreement (to which B has become bound). As proposed in Study Committee Recommendation 17.F.2, a special priority rule will be necessary to resolve the priority contest between SP-A and SP-B if the Drafting Committee adopts the Second Alternative draft § 9-402A. But if the Drafting Committee adopts the First Alternative § 9-402A, then any filing that SP-A has made against A will be ineffective as to B's property and the usual priority rules would apply.

2. Subsection (w) (both alternatives) would award priority to SP-B in all cases where SP-B's security interest has attached and is perfected before B becomes bound by the security agreement in favor of SP-A. As in the case of the "double debtor" problem addressed above by draft § 9-312(v), the first-to-file-or-perfect rule of § 9-312(5)(a) is meaningless as between SP-A and SP-B.

3. The First Alternative subsection (w) resolves the priority contest between SP-A and SP-B by providing that the time of filing of SP-A's financing statement is deemed to be the time when B became bound by the security agreement in favor of SP-A. If SP-B is not yet in the picture, then SP-A's security interest will be prior under § 9-512(5)(a) as to the collateral acquired before and during the four-month period and, if SP-A files an appropriate amendment within that period, as to collateral acquired thereafter. If SP-B enters the picture during the four-month period it must rely on B (the debtor) and its investigation in order to discover SP-A's "secret lien" (i.e., SP-A has not filed against B; SP-A's security interest is perfected by the continued effectiveness of its filing against A).

4. The Second Alternative subsection (w) would recognize that SP-A's secret lien during the four-month period might be more difficult for a prospective creditor like SP-B to discover than is the case with transactions giving rise to similar secret liens, such as the movement of collateral to a new jurisdiction (§ 9-103(1)(d)) or a change in the location of a debtor (§ 9-103(3)(e)). It would subordinate SP-A's security interest to all other security interests, such as SP-B's, that are perfected by a means other than the continued effectiveness of a financing statement under draft § 9-402A(c) and (d)(1). Because SP-A's security interest would be perfected, however, it would be senior to the interest of a lien creditor and to unperfected security interests. Once SP-A filed a proper amendment under draft § 9-312(3)(b), the usual priority rules would apply.

5. Subsection (w) provides a priority rule for contests between two secured parties, SP-A and SP-B. It does not address the relative rights between SP-A and another purchaser, such as a non-ordinary course buyer or other non-secured party transferee during the four-month period. Because SP-A's security interest would continue to be perfected, such non-ordinary course purchasers normally would take subject to SP-A's security interest. §§ 9-201; 9-301(1)(c) & (d). The Drafting Committee may wish to provide protection for these purchasers.