

## UCC Financing Statements - Continuation and Lapse

The UCC's general rule is that a financing statement remains valid for a period of five years from the date of filing. Unless a continuation statement is properly filed before expiration of the five year period, the effectiveness of the financing statement will lapse.

### Effect of Lapse

At the time a financing statement lapses, any security interest that is perfected solely by that financing statement becomes unperfected. Further, as to competing secured creditors and other purchasers of the collateral for value, the security interest is treated as if it never had been perfected at all: a situation often referred to as "retroactive unperfection."

#### *Example 1*

Bank extends long term credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its financing statement identifying the tractor as collateral. Bank forgets to file a continuation statement, and the effectiveness of Bank's financing statement lapses on January 1, 2015 despite the fact that the secured obligation has not been repaid in full.

On February 1, 2015, Farmer obtains a loan from AgLender, with the loan secured by all equipment of Farmer. AgLender files its financing statement, covering all equipment, on February 2, 2015.

Bank realizes its mistake, and on March 1, 2015 files a new financing statement identifying the tractor as collateral.

Who has priority? AgLender. Despite the fact that a portion of the secured indebtedness to Bank remained unpaid on January 1, 2015, the financing statement lapsed because no continuation statement had been filed. On that date, Bank's security interest in the tractor became unperfected. Under ordinary priority rules, because AgLender's February 2, 2015 financing statement was filed *before* Bank's March 1, 2015 financing statement, AgLender is entitled to priority.

#### *Example 2* (taken from a recent Georgia Court of Appeals case)

Bank extends purchase money credit to Debtor, enabling Debtor to purchase a timber harvester. Debtor purchases and receives possession of the harvester on June 1, 2008. Bank properly files a financing statement covering the harvester on June 5, 2008.

On April 1, 2012, without informing Bank, Debtor transfers the harvester to Dealer as a "trade in" for credit against the purchase price of new equipment. Dealer is unaware of Bank's security interest, but does not conduct a UCC search to determine if any financing statements may have been filed with respect to the Debtor. Dealer accepts the harvester as a trade in, in exchange giving Debtor a \$50,000 credit upon the purchase of new equipment. Later, on May 1, 2012, Dealer sells the harvester to a third party. Bank is unaware that the harvester was transferred to Dealer, or that Dealer sold the harvester.

Bank forgets to timely file a continuation statement, but eventually realizes its error. On October 1, 2013 (more than five years after the initial financing statement filing) Bank files a second financing statement covering the harvester. Shortly thereafter Bank discovers that the harvester has been traded and sold by Dealer. Bank sues Dealer for converting the harvester, claiming that

when the harvester was accepted and sold by Dealer in 2012 Bank's financing statement had not yet lapsed and Bank was perfected at that time.

Result? Due to retroactive unperfection, Dealer has no liability to Bank.

When Bank's financing statement lapsed on June 5, 2013, it was as though, as against purchasers for value, Bank had never been perfected at all. Dealer was a purchaser for value, as it gave trade credit to Debtor in exchange for the harvester. So, as against Dealer, it was as though Bank had been unperfected from the outset.

The UCC's general rule is that a buyer takes free of an unperfected security interest as long as the buyer does not actually know about the security interest. Since Dealer did not actually know about Bank's security interest when it accepted the harvester, and since Bank's interest was (retroactively) unperfected at that time, Dealer took the harvester free from any security interest held by the Bank. The fact that Dealer could have known about Bank's security interest by conducting a UCC search has no effect on Dealer's liability in this instance.

### *Example 3*

Bank extends long term credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its financing statement identifying the tractor as collateral.

On March 1, 2012, Bank makes an operating loan to Farmer secured by all of Farmer's equipment. On the same date, Bank files a financing statement covering all of Farmer's equipment.

On March 1, 2013 Farmer obtains a loan from AgLender, secured by all of Farmer's equipment. On the same date, AgLender files a financing statement covering all of Farmer's equipment.

Bank forgets to file a continuation statement prior to January 1, 2015, and on that date the effectiveness of the January 2010 financing statement lapses.

Who has priority as of February 1, 2015? Bank. Bank was perfected by virtue of the January 2010 financing statement **and** the March 2012 financing statement. Although the earlier financing statement lapsed on January 1, 2015, the latter remained effective to perfect Bank's security interest in the tractor. Because Bank's March 2012 financing statement was filed before AgLender's March 2013 financing statement, Bank is entitled to priority.

### *Example 4*

Bank extends credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its financing statement identifying the tractor as collateral. Bank forgets to file a continuation statement, and the effectiveness of Bank's financing statement lapses on January 1, 2015 despite the fact that the secured obligation has not been repaid in full.

Bank realizes its mistake, and on March 1, 2015 files a new financing statement identifying the tractor as collateral. No other creditor had filed a financing statement with respect to the tractor at any time prior to that date.

What is Bank's status? At the time Bank filed its second financing statement on March 1, 2015, it again became a perfected secured creditor. Since there were no intervening secured creditors, Bank remains in first priority. The lapse of the financing statement did not cause Bank to become

*unsecured*—it just caused Bank to become *unperfected*. During the period between January 1 and March 1 of 2015, Bank was a secured, but unperfected, creditor as to the tractor. Its security interest remained valid, and would have remained valid until the secured obligation was repaid in full.

Notice that if Bank had merely filed an untimely continuation statement after the January 1, 2015 lapse instead of filing a new financing statement, Bank would remain an unperfected creditor. Once a financing statement lapses, the creditor is unperfected and it is necessary to comply with all requirements for an initial financing statement in order to regain perfection.

### **Time Limitations for Filing a Continuation Statement**

The financing statement is valid for five years from the date of its filing, and a continuation must be filed prior to expiration of the five year period in order to prevent lapse. However, a continuation statement cannot effectively be filed at any time during the five year period. In order to be valid, the continuation statement must be filed within the six month period before the expiration of the financing statement's five year life. If the continuation statement is filed earlier, it will be ineffective.

#### *Example*

Bank extends credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its financing statement identifying the tractor as collateral.

Bank is anxious not to let its security interest lapse, so on January 1, 2014 Bank files a continuation statement a full year ahead of the projected date of lapse. Satisfied it now has an additional five years, Bank takes no other action to continue the initial financing statement prior to January 1, 2015.

What is Bank's status on February 1, 2015? Bank is an unperfected creditor. The January 1, 2014 filing was wholly ineffective to continue Bank's initial financing statement, as it was filed earlier than the six month "window" afforded for filing continuation statements.

### **Successive Continuation Statements**

The UCC clearly permits a creditor to use successive, timely filed, continuation statements to maintain perfection for an unlimited period of time—all the creditor has to do is keep filing a continuation every five years. However, calculating the deadline to file a second (or third, or fourth) continuation statement sometimes causes confusion.

The key to avoiding confusion is to remember that a properly filed continuation statement continues effectiveness for a period of five years **from the date the financing statement would have otherwise lapsed**—not a period of five years from the date the continuation statement is filed. Because filings are limited to a six month window, miscalculating the new period of effectiveness can cause the creditor to become unperfected when a second continuation is filed.

#### *Example*

Bank extends credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2006, Bank files its financing statement identifying the tractor as collateral.

On August 1, 2010, Bank timely files a continuation statement. Believing the financing statement will now remain valid for another five year period from the date of filing the continuation statement, Bank calendars August 1, 2015 as the potential date of lapse.

On April 1, 2015, Bank files a second continuation statement. Bank's logic is that April 1 is within the six month period prior to August 1—when Bank thinks the financing statement will lapse. Bank thereafter does not take any additional action to continue the financing statement.

What is Bank's status? On January 1, 2016, Bank becomes unperfected.

The April 1, 2015 continuation statement was filed too early as it was not filed within six months before the date of lapse (January 1, 2016).

It may be helpful to think of continuation periods as anniversaries from the initial filing. Each five year anniversary of the initial filing is a potential time of lapse. Potentially, a creditor could schedule continuation deadlines for centuries knowing only the date of initial filing. The actual date of filing a timely continuation statement—i.e., whether it was filed five months before lapse or five days before lapse—does not matter for continuation purposes.

#### *Example*

Bank extends credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its initial financing statement identifying the tractor as collateral.

On September 1, 2014, Bank timely files its first continuation statement.

On December 1, 2019, Bank files a second continuation statement.

What is Bank's status? Bank's financing statement remains effective, even though more than five years elapsed between the filing of the first continuation statement (September 1, 2014) and the filing of the second continuation statement (December 1, 2019).

The question is not how much time has elapsed between continuation statement filings, but instead whether each individual continuation statement was filed within six months prior to the anniversary of the initial filing. Because that is true with respect to both continuation statements in the example, the effectiveness of the financing statement is continued for another five years from January 1, 2020.

### **Content Requirements for Continuation Statements**

For most types of personal property collateral, the content requirements for an effective continuation statement are minimal. The document must (a) identify, by file number, the initial financing statement to which it relates; and (b) indicate that it is filed as a continuation statement. These requirements are easily satisfied. For the first requirement, one inserts the file number shown on the initial financing statement, as affixed by the clerk where it was filed, in Item number 1a on form UCC-3. For the latter requirement, one just checks the "continuation" box (Item number 4) on form UCC-3.

If the initial financing statement was filed in the real property records, however (for example it was filed with respect to growing crops or standing timber), content requirements are more strenuous. The UCC states that if the initial financing statement was filed in the real property records, then any continuation statement or other amendment must itself:

1. identify the type of collateral covered;
2. indicate that it is to be filed in the real property records;
3. provide a description of the real property to which the collateral relates; and
4. if the debtor does not have an interest of record in the real property, provide the name of the record owner of the real property.

In other words, the continuation statement must have essentially the same information as the initial financing statement. This will require use of the amendment addendum form (UCC-3Ad) in addition to the ordinary amendment form (UCC-3), with the appropriate description and ownership information being inserted in the addendum.

It is not uncommon for a creditor to overlook the substantial content requirements for a continuation filed in the real property records. The courts of this State have yet to decide whether omitting a portion of the required information will render the continuation invalid. The safest course of action is to strictly abide by the UCC's requirements, being sure to insert the appropriate information whenever a continuation (or other amendment) is filed in the real property records.

### **Is it a Continuation or an Amendment? What Difference Does it Make?**

In UCC terminology, a *continuation statement* is a type of *amendment*. A *termination statement* is also a type of *amendment*. In other words, all continuation statements are amendments, but not all amendments are continuation statements.

For practical purposes, all types of amendments—continuation statements, termination statements, and ordinary amendments—are accomplished using the same form (UCC-3, and as necessary, UCC-3Ad). The difference is what box is checked on the form. If only Item 4 (“continuation”) is checked, then the filing is a continuation statement; if only Item 2 (“termination”) is checked, then it is a termination statement.

For legal purposes, a continuation statement is distinguished from other types of amendment in that a continuation statement indicates that it is filed for purposes of continuing the effectiveness of the initial financing statement. Absent this indication (which, again, is done by checking Item 4) the document is **not** effective as a continuation statement, and it will **not** continue the effectiveness of any financing statement beyond its original date of lapse.

In isolation this seems logical and straight forward. In practice, it is occasionally problematic to lenders. Lenders sometimes overlook the fact that an ordinary amendment will not extend the life of an initial financing statement. Only a continuation statement can do so.

#### *Example 1*

Bank extends long term credit to Farmer, with the loan secured by Farmer's FieldCo tractor. On January 1, 2010, Bank files its financing statement identifying the tractor as collateral.

Later, in October of 2014, Farmer informs Bank that he would like to sell the tractor. Bank does not object to the proposal, as long as it receives sufficient other collateral as a substitute. In exchange for Bank allowing the tractor to be sold free of Bank's security interest, Farmer grants

Bank a security interest in his FieldCo combine. On October 15, 2014, Bank files an amendment deleting the tractor as collateral and adding the combine as collateral.

Believing it now has a valid financing statement covering the combine for an additional period of five years, Bank takes no other action to continue the financing statement prior to January 1, 2015.

What is Bank's status of February 1, 2015? Bank is unperfected, both as to the tractor and the combine. Even though it was filed within the "six month window," the amendment was not a continuation statement and thus did not extend the lifespan of the initial financing statement.

### *Example 2*

Bank extends a loan to John Farmer on February 1, 2010, with the loan secured by all of John's equipment. Bank files its financing statement, covering all equipment, on February 1, 2010.

On March 1, 2013, Bank extends a new loan to John Farmer and his son Robert Farmer, jointly. The loan is secured by all equipment of each debtor. On March 1, 2013, Bank files an amendment to its original financing statement, adding Robert Farmer as an additional debtor.

Believing its original financing statement will remain effective for an additional five years after the amendment is filed, Bank takes no additional action to continue the financing statement before February 1, 2015.

What is Bank's status as of February 2, 2015? It is unperfected as to both John's equipment and Robert's equipment. The amendment did not serve as a continuation statement, as it only added an additional debtor.

This example further shows that amending an existing financing statement, rather than filing a new financing statement, is not always the preferred option when adding an additional debtor. As to the new debtor, perfection only dates from the time the amendment is filed—it does not "relate back" to the date of the original financing statement. So, the lender would have equivalent priority if it simply filed a new initial financing statement naming the "new" debtor. When an amendment is used, perfection is limited to the life of the original financing statement, rather than the five year life of a new initial financing statement.

So, if instead of using an amendment in the above example, Bank had filed a new financing statement for Robert Farmer, Bank would have remained perfected as to Robert's equipment until March 1, 2018.

Can the same document serve as both an amendment changing collateral (or other information), and as a continuation statement? In other words, using the facts from Example 1 above, could Bank have submitted a single UCC-3 form that has Item 4 (continuation) checked, and Item 8 (collateral change) checked?

The UCC leaves this to the discretion of the filing office. It does not expressly declare a single amendment form, filed for multiple purposes, as invalid. In Georgia, the Superior Court Clerks Authority (a group that handles much of the administration of UCC indexing, and comprises the various Clerks of Superior Court in the state) has issued instructions providing that a single amendment (UCC-3) form **cannot** be used to accomplish multiple purposes. A separate form must be submitted for each purpose.

So, in our example, Bank would need to submit one UCC-3 showing the change of collateral in Item 8, and a separate UCC-3 to serve as a continuation statement by checking Item 4.

### **Exception to the Five Year Rule: Mortgages as Financing Statements**

Georgia's 2013 UCC Amendments brought Georgia into line with most other states by permitting a mortgage (or deed to secure debt) to serve as a financing statement with respect to fixtures, as-extracted collateral (minerals), and timber to be cut. While a mortgage filed after July 1, 2013 can have a similar effect to a financing statement (assuming the minimal UCC content requirements are met), the mortgage is not subject to the same five year lifespan as a financing statement.

Under Georgia law, a mortgage effective as a financing statement remains effective until either (a) the mortgage is satisfied or released of record, or (b) the mortgage becomes ineffective as to the underlying real property under state property law. So in other words, unless the lender voluntarily releases the mortgage, it will remain effective as a financing statement until title reverts to the borrower under real property rules. Determining the time period for reversion under a security deed is fact specific and involves nuanced rules, but generally speaking the lifespan of a mortgage or security deed will be substantially longer than the five year life afforded to ordinary financing statements.

### **Continuation Following "Name Change" Caused by 2013 Amendments**

The 2013 amendments to Georgia's Uniform Commercial Code introduced a new, inflexible rule for determining the name of an individual debtor: if the individual has a valid Georgia driver's license, the name of the individual as shown on a financing statement must exactly match the name shown on the driver's license. This is true even if another official document such as a passport or marriage certificate shows a different name, and even if an event such as a marriage or divorce has caused the debtor's "legal" name to change since the driver's license was issued. As a result, a name that was appropriate prior to 2013 may no longer be sufficient.

The amendments' authors included special transition provisions in an attempt to lessen the harsh effect of the new rule. The transition provisions state that if a financing statement is effective to perfect the lender's interest prior to the effective date of the amendment, the financing statement will remain effective until it would have expired absent the amendment. However, where the name shown in a pre-amendment financing statement becomes improper because of the amendment, that financing statement cannot be continued beyond its initial lapse date unless the lender files a financing statement amendment correcting the name shown for the debtor. In other words, the lender will need to be sure of the proper name for the debtor when continuing financing statements filed prior to the 2013 amendments. This may entail a review of the debtor's driver's license in advance of the deadline for continuation.

If the individual debtor's name as stated in the pre-amendment financing statement is different from that individual's valid Georgia driver's license, the lender will need to file an amendment showing the new, correct name for the debtor before a continuation statement is filed. Otherwise the pre-amendment financing statement may become ineffective (due to incorrect name) at the scheduled lapse date, even if a continuation statement is timely filed.

As explained more fully above, separate UCC-3 forms should be filed for the name change amendment and the subsequent continuation statement. From a filing perspective, an amendment to show a name change resulting from the 2013 amendments is no different than an amendment to show a name change resulting from other reasons. The GSCCA has instructed that a single UCC-3 document should not be used for both name change and continuation purposes. While some county clerks might allow use of a single document in disregard of those instructions, others may reject the document and return it to the

creditor—meaning nothing gets filed, and deadlines can be missed. The safest practice is to submit two separate UCC-3 documents (a name change amendment, and a continuation statement) where a name change submission is required before continuation.



