[Missouri Law Review](https://scholarship.law.missouri.edu/mlr)

Volume 52
Issue 1 *Winter 1987*

Article 8

Winter 1987

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F. Stephen Knippenberg

DEBTOR NAME CHANGES AND COLLATERAL TRANSFERS UNDER 9-402(7): DRAFTING FROM THE OUTSIDE-IN

F. Stephen Knippenberg*

INTRODUCTION

Article 9 of the Uniform Commercial Code[1] ("the Code") has received considerable scholarly attention.[2] This is scarcely remarkable given that Article 9 has brought order and uniformity[3] to the field of secured financing

* Visiting Assistant Professor of Law, University of Toledo College of Law. LL.M., Temple University School of Law, J.D., University of Tulsa College of Law, B.A., University of Dayton. This article was substantially prepared during my tenure as a Graduate Teaching Fellow at Temple University School of Law.

1. Citations are to the Uniform Commercial Code 1978 Official Text unless otherwise noted. Except for transactions excluded by section 9-104, Article 9 applies "to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also . . . to any sale of accounts or chattel paper." U.C.C. § 9-102(1).

2. There are at least four articles devoted entirely to the rather narrow questions raised by section 9-402(7). *See* Burke, *The Duty to Refile Under Section 9-402(7) of Revised Article 9*, 35 BUS. LAW 1083 (1980); Westbrook, *Glitch: Section 9-402(7) and the U.C.C. Revision Process*, 52 GEO. WASH. L. REV. 408 (1984); Note, *The Effect of Errors and Changes in the Debtor's Name on Article Nine Security Interests*, 1975 DUKE L.J. 148 [hereinafter Duke Note]; Note, *Debtors' Name or Identity Changes: Distributing Benefits and Burdens Under Article 9*, 31 HASTINGS L.J. 959 (1980) [hereinafter Hastings Note]. These, in addition to other articles giving some attention to that provision in the course of discussing related matters and articles bearing on the matter of debtor name changes and transfer of collateral are noted throughout this article.

3. Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROBS. 27 (1951) ("Article 9 . . . proposes to integrate, under a single system of legal propositions and a single system of terminology, the entire range of transactions in which money debts are secured by personal property.").

where before there existed only diversity.[4] Ambition and innovation on a grand scale invite scrutiny, explication and, sometimes, criticism.[5]

Often, however, it seems that scholarly discussions of Article 9 are tests for internal consistency among the provisions and parts of the Article—the measuring of one clause or provision against another for syllogistic compatibility.[6] The universe in which consistency is measured is frequently limited to the Article itself. This is by no means to assert that Article 9 scholarship has ignored commercial reality and case law; rather, it is only to suggest that what the drafters of the Article believed to be the realities of secured transactions[7] is not always given the consideration it is due in discussions aimed at problematic language from the Article.

The drafters' perceptions of the world of secured credit financing are at times evident from the Article, but are not always expressly declared. Even

4. The story of pre-Code security law is briefly, but effectively, included in the official comment to section 9-101. The Article's drafters describe the forlorn attempts of an outmoded system of diverse statutes to accommodate increasingly sophisticated credit transactions. The attempts seem to have consisted mainly of the piling up of new statutory provisions resulting in what must have been a nightmare maze of complexity attended by "increasing costs to both parties [to the secured transaction] and increasing uncertainty as to their rights and the rights of third parties dealing with them." U.C.C. § 9-101 official comment.

Those interested in the history of pre-Code security devices and security law should see G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY (1965). The author also traces the development and drafting of Article 9 to its roots in pre-Code security statutes. He discusses in some detail that which Article 9 owes to prototype statutes such as the Uniform Trust Receipts Act, and he alerts readers to points of departure and innovation.

5. Professor Gilmore declared that "[n]o other Article of the Code proposes so radical a departure from prior law." Unlike other Articles, such as Article 2 on sale of goods which codifies prior law to a much greater extent, Article 9 "deliberately cuts loose from all anchorage in the past." GILMORE, *supra* note 3, at 27-28. Gilmore's article also contains an engaging account of the criticisms of the more controversial provisions of Article 9.

For a discussion of the advances in security law made by Article 9 in the areas of accounts receivable and inventory financing, see Kripke, *The Modernization of Commercial Security Under the Uniform Commercial Code*, 16 LAW & CONTEMP. PROBS. 183 (1951).

6. *See* Duncan & Lyons, *Perfection of Security Interests Under Article 9: Changed Circumstances and the Duty to Refile within a Given State*, 65 NEB. L. REV. 445 (1986); Westbrook, *supra* note 2. In the former article, the authors conclude that section 9-402(7) permits "secret liens" in some cases, a "result [which] contradicts the goals of the concept of notice filing upon which Article 9 has been constructed." Duncan & Lyons, *supra*, at 448-49. In the latter, the author reaches a similar conclusion on much the same basis. Westbrook, *supra* note 2, at 414-15.

7. The drafters' perceptions of the economic realities of secured credit should not be accepted as accurate for all times in all places. Instead, it is suggested that these perceptions—acquired episodically through experience—cannot be ignored in measuring the consistency and compatibility of a Code provision or series of provisions. *See infra* note 108 and accompanying text.

the official comments may be more the formal conclusions and directives that follow from the perceptions upon which they are based rather than a statement of the perceptions themselves.[8] To overlook the drafters' notions of commercial reality, or to fail to discover them, is to limit the universe the Article's provisions occupy, with the result that a particular provision may come to be regarded as obtuse and anomalous, out of step with other provisions or, perhaps, the whole of the Article. Attention to the drafters' perceptions, empirically accurate or otherwise[9], may occasionally rescue such provisions. If the following discussion of section 9-402(7) is yet another attempt to discovery harmony among Code provisions, it is also an emphatic effort to expand the scope of analysis to include those perceptions in the attempt.

Notice Filing

Those who would extend credit have always to contend with the unhappy prospect that they might not be repaid. Determining the probability of repayment without compulsion is the object of credit investigations[10] predicated upon the notion that borrowers known to satisfy their debts in the past are likely to do so in the future, more likely, at least, than borrowers with a

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8. Official comments 7-8 to section 9-402(7) are illustrative. The comments quite clearly describe how burdens are distributed in cases of name change and collateral transfer, but they do not include the information and experience upon which the decision to distribute those burdens was based. U.C.C. § 9-402(7) official comments 7-8.

9. I add my voice to the voices of a few others calling for empirical scholarship to precede critical analysis of Code provisions and other areas. *See, e.g.*, W. Woodward & Woodward, *Exemptions As An Incentive To Voluntary Bankruptcy: An Empirical Study*, 57 AM. BANKR. L.J. 53 (1983); *see also infra* note 123.

10. It has been proposed that decisions to extend credit are based upon financial reports and the reports of investigative agencies, and that the information concerning the status of a borrower's personalty gathered from filing systems does not figure largely in reaching the decision. G. GILMORE, supra note 4, at 463-65. In fact, some early drafts of Article 9 would have abandoned filing altogether. The abandonment idea met with fierce opposition, the fiercest of which, according to Gilmore, issued from the ranks of secured party lenders, the victims of the old burdensome filing systems whom one might reasonably expect to be thrilled at the idea. *Id.* at 464. This peculiar fact offers support to the notion that the filing system of Article 9 is for filers, not searchers. *See infra* note 22 and accompanying text; *see also infra* note 97.

On the other hand, it must be noted that the supposition at the bottom of the abandonment proposal—that the decision to lend does not really depend on information to be had from the U.C.C. filings—does not seem to have rested on any systematic empirical study. There is a dearth of empirical information one way or the other. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 19 n.95 (2d ed. 1980).

contrary credit history. Ensuring repayment in any event is the business of the security device.[11]

Where credit is extended on the strength of a borrower's personalty offered up as collateral to secure the loan, the transaction is governed by Article 9 of the Uniform Commercial Code,[12] and the security device is an Article 9 security interest.[13] The advantages of the security interest are many. It may be created[14] and maintained with relative ease[15], and once created permits direct seizure of the collateral in the event of default.[16] As a creature of Article 9, the security interest is necessarily attended by provisions of the Article governing perfection of the interest[17] and those establishing priorities

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11. So far as Article 9 is concerned, security device means security interest, though as Professor's White and Summers point out, there is no "official" name for the Article 9 security device. J. WHITE & R. SUMMERS, *supra* note 10, at 874. The security interest is defined *infra* note 13.

12. *See supra* note 1 (quoting section 9-102 on the scope of Article 9).

13. A security interest is "an interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37).

14. Creation of a valid security interest, by virtue of which one becomes a "secured party" (§ 9-105(m)) with a property interest in the "collateral" (§ 9-105(c)) is a straightforward affair. The governing provision is section 9-203(1). To be enforceable against anyone, including the debtor, the security interest must "attach", and attachment requires three conditions to be met. First, unless the secured party has possession of the collateral, there must be a written security agreement signed by the debtor and containing a description of the collateral. Second, the secured party must have "given value" for the interest to be granted, and finally, the debtor must have "rights in the collateral." U.C.C. § 9-203(1). The phrase, "rights in the collateral," is not expressly defined by the Code. Thus, it has not always been clear when a debtor has rights sufficient for this purpose. For a discussion of this point, see J. WHITE & R. SUMMERS, *supra* note 10, at 916.

15. In fact, the security interest may be maintained with no effort at all. If the interest is perfected, it remains so for five years and may be extended beyond five years by the filing of a continuation statement in accordance U.C.C. § 9-403(3).

16. Armed with a security interest, the secured party is in a position to capture the collateral in the event of the debtor's default. Part 5 of Article 9 governs how this is accomplished. It permits the secured creditor to retain the collateral in full satisfaction of the debt or to sell the collateral and satisfy the debt from the proceeds. In either event, the secured party may exercise his rights on default without recourse to the courts, provided only that he do so without a breach of the peace. U.C.C. §§ 9-503, -504.

17. If it is attachment that gives the secured party property rights in the collateral which may be enforced against the debtor, it is perfection that gives the secured party rights to the collateral when facing claims of third parties. *See infra* note 18 (discussing priorities among competing claimants to the collateral).

If the security interest is to survive the claims of third parties, it must be perfected. Perfection is accomplished in any of three ways, depending upon the nature of the collateral, but it is first necessary that the secured party have a valid and enforceable security interest at some point along the way. U.C.C. § 9-303. Given this, in some limited circumstances, the secured party need take no additional steps to perfect the security interest; perfection is said to occur automatically upon the among competing claimants to the collateral[18], such that the secured party[19] enters the transaction enlightened of his status in the collateral relative to that of third-party claimants.[20]

The security interest offers two important opportunities to would be secured creditors. These are the opportunity to discover in advance of extending credit whether the debtor's personalty is already encumbered by prior security interests,[21] and the opportunity to stake a claim[22] to the collateral if

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attachment of the security interest. *Id.* § 9-303(1). Instances of automatic perfection are few. *See, e.g., id.* § 9-302 (1)(d) (purchase money security interest in consumer goods); § 9-302(1)(e) (transfer of insignificant part of accounts). There are also cases of temporary automatic perfection. *See id.* § 9-304(4) (security interest in instruments or negotiable documents is automatically perfected for 21 days under certain conditions).

Leaving aside the automatic method, the secured party must either take possession of the collateral or file a financing statement. As to some kinds of collateral, for example, "goods" as defined under section 9-109, the secured party has the option of filing or taking possession. Of course, where the goods are the debtor's inventory or equipment, taking possession is impractical, and fortunately, the secured party may file to perfect. U.C.C. § 9-302(1). In other cases, the secured party must take possession, for instance, when the collateral is an instrument or money. *Id.* § 9-304(1). Finally, in some cases, the interest can be perfected only by filing. *See, e.g., id.* §§ 9-302, -305 (accounts receivable). In any event, filing is the most common method of perfection, the method by which the majority of security interests are probably perfected. J. WHITE & R. SUMMERS, *supra* note 10, at 918.

18. In a priority battle among creditors all asserting an interest in the collateral, the status of unperfected secured party amounts to very little status indeed. There are few claims subordinate to the unperfected security interest. *See* U.C.C. § 9-301(1)-(4). There are a variety of priority provisions in Article 9, e.g., section 9-307 concerning the matter of priority as between secured parties and buyers in due course and section 9-310 concerning priority disputes between secured parties and lienholders furnishing goods or services "with respect to goods subject to a security interest." Two provisions are of special interest here, namely, sections 9-301(1)(b) and (3), and 9-312(5). Section 9-301(1)(b) states by negative implication that a perfected secured party is prior to a "lien creditor" which, according to subsection (3) includes the debtor's trustee in bankruptcy, provided the interest is perfected prior to the petition being filed. U.C.C. § 9-301(3).

Section 9-312 is the basic priority rule which decides priority disputes between secured parties, and subsection 5 establishes priority in such cases according to who perfected first. In short, section 9-312(5) makes Article 9 a "race statute" for the most part. Since perfection is most commonly accomplished by filing (see *supra* note 17 and accompanying text), priority among competing security interests is often a question of who files first. The secured creditor who was first to file gains as much protection against third party claims as can be had under Article 9. U.C.C. § 9-312(5).

19. A "secured party" is one in whose favor there is a security interest. U.C.C. § 9-105(1)(m).

20. The universe of claimants may include a variety of persons, such as the debtor's unsecured creditors whose cause is championed by the debtor's trustee. *See generally supra* note 18.

21. This is the public notice function, as distinguished from the "claim stak-

it is decided the transaction should be undertaken. Both opportunities are a function of perfection.[23] While the steps to perfecting a security interest vary according to the nature of the collateral, the general rule under the relevant provisions of Article 9 calls for the filing of a financing statement.[24] The other methods of perfection are more or less exceptions to that rule.[25] In any event, the financing statement is the vehicle of the notice filing system of Article 9;[26] and, it is the notice filing concept, likely the most profound contribution of Article 9 to the field of secured financing[27], which is the source of the discovery and claim-staking opportunities.

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ing" function. The term "notice filing" is often used in discussing or describing the public notice function of filing, but it may be misleading to equate notice filing with the public notice or discovery function. *See infra* notes 22, 27, and accompanying text.

22. So far as I know, the term "claim staking" as it is used here originates with Professor Douglas Baird. Baird, *Notice Filing and the Problem of Ostensible Ownership*, 12 J. LEGAL STUD. 53, 62 (1983). However, Professor Baird attributes to Alan Schwartz and Robert Scott the application of a "prospecting theory" to the notice filing system. *Id.* at 63. In any event, Professor Baird makes the following analogy:

> The notice-filing system is like the law governing mineral claims because it makes the existence of property rights public in a clear and unambiguous way. A prospector in the Old West could explore land, confident that no one else had a claim to it that would be superior to his so long as no markers indicated it belonged to someone else. Similarly, a creditor can lend money to a debtor with confidence because he knows (by looking at the files) that no other existing creditor can claim an interest in the property superior to his own.

Id. The prospecting analogy is an important concept to Professor Baird's article, in which he concludes that the notice filing system is directed to a very narrow aspect of the ostensible ownership problem (see generally *infra* note 23 and accompanying text), namely, "the one arising from competition between secured creditors." *Id.* at 66. In any event, the term "claim staking" is used here to distinguish this function from the public notice function of the Code's notice filing system. The relative importance of either function depends on one's perspective. From the point of view of the filer, the notice filing system is designed to capture first priority in the debtor's property, whereas from the point of view of the searcher, it may be that the filing system is first and foremost a source of information, a system of public notice.

23. *See supra* note 17 and accompanying text. In theory, possession or filing both afford the claim staking and notice opportunities. Possession of the collateral—the "pledge"—antedates filing by centuries. It is based on the notion that if the pledged collateral is left in his posssession, the debtor will either sell the encumbered property to an innocent person unaware of the creditor's interest or at least seek credit while holding out the pledged collateral as unencumbered. *See infra* note 131 and accompanying text. If the secured party perfects by taking possession, the claim staking function is plainly served and the creditor's possession gives trustworthy notice of the security. *See generally*, Baird & Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175 (1983).

24. *See supra* note 17.

25. *Id.*

26. *See infra* note 27.

27. Section 9-402 adopts the "notice filing system," a system essentially bor-

That is, the notice filing system is simultaneously a source of information for those who would transact with reference to a debtor's personalty and a mechanism by which security interests are proclaimed. Put another way, the notice filing system serves both notice-giving and claim-staking[28] functions, although the two cannot be considered entirely independent since notice of a security interest is, in theory, given upon the staking of a claim by filing.

The key to notice filing is the financing statement[29]. The financing statement, properly prepared so that it accurately identifies the debtor and sufficiently describes the collateral,[30] and presented to the appropriate filing

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rowed from the Uniform Trust Receipts Act. U.C.C. § 9-402 official comment 2. The choice of the term "notice filing" may, however, have been an unfortunate one to the extent the words "notice filing" are equated with public notice. It should not be concluded from the words "notice filing" that the public notice function is necessarily the driving consideration behind the notice filing system. The significance of the term rests in the difference it describes between an abbreviated system of filing and "transaction filing". *Id.*; *see also* Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289, 290 (1962); Dunham, *Inventory and Accounts Receivable Financing*, 62 HARV. L. REV. 588, 610 n.45 (1949). Pre-Code filing schemes frequently required the security agreement itself be filed and were often attended by ritualistic affidavits crammed with formal recitations of the parties' expectations and scrupulous descriptions of collateral, generally functioning as monuments to punctilio for its own sake. G. GILMORE, *supra* note 4. These excesses in the pre-Code filing schemes appear to be traceable to anxiety over the ostensible ownership problem, discussed *supra* note 23. The drafters of Article 9 abandoned the transaction filing approach in favor of notice filing. (Section 9-402(1), however, does *permit* the security agreement to be filed in lieu of the financing statement.) This means that a document other than the agreement creating the security interest—the financing statement—is filed to perfect. The financing statement provides barebones information and requires very little of the secured party in its preparation. U.C.C. § 9-402; *infra* note 29.

28. Lest the reader be misled, it is not here proposed that claim staking is the exclusive object of notice filing. As Professor Coogan observes, "All filing systems, of course, are intended to give notice to others." Coogan, *supra* note 27, at 290. Rather, the point is simply that notice filing includes the claim staking function to the extent the term is descriptive of an abbreviated form of filing.

29. The financing statement is a model of simplicity. Its formal requirements are few. *See generally* U.C.C. § 9-402. The financing statement must contain the names of the debtor and secured party, the secured party's address "from which information concerning the security interest may be obtained," a mailing address for the debtor and a description of the collateral. *Id.* This scanty information "indicates merely that the secured party who has filed may have a security interest in the collateral described." *Id.* official comment 2. So far as notice filing is concerned, this is enough. For a discussion of the relative value of information about the security interest to various parties, see *infra* notes 96-99 and accompanying text.

30. In keeping with the idea that the financing statement need do no more than alert the searcher to the possibility of a security interest, exactitude is not required in describing the collateral, although a description of some specific items is required by section 9-402(1). Be that as it may, it was contemplated that only so much descriptive detail as is necessary for the collateral to be reasonably identifiable be included in the financing statement. As to how much description is enough, the Code

officer[31] for indexing according to the debtor's name,[32] places the secured party in a position prior to third party claims to the collateral which thereafter arise.[33] The financing statement is likewise there to be discovered by all who search the index under the debtor's name, thereby alerting the world that the personalty described is encumbered.[34]

Where a financing statement properly identifies the debtor and is correctly indexed, both the claim-staking and notice-giving functions of the

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offers guidelines in section 9-110 (arrived at by way of cross-reference from section 9-402) which provides: "For the purposes of this article any description of personal property . . . is sufficient whether or not it is specific if it reasonably identifies what is described." U.C.C. § 9-110. The test of sufficiency is one of reasonableness, and whatever that may mean from one case to the next, it is emminently clear that an exact, highly specific description—a "serial number test"—is not required. *Id.* official comment. For a discussion of the description issue and the cases considering it, see J. WHITE & R. SUMMERS, *supra* note 10, at 961-64.

31. In intrastate transactions the question of where to file is answered according to how the collateral is classified. *See* U.C.C. § 9-401. Depending upon the classification, filing will either be local—for instance, in a county clerk's office where real estate records are maintained—or central—the office of the secretary of state. There appears to have been a difference of opinion at the time Article 9 was drafted whether central statewide filing or local filing should be adopted. The statewide system of the Uniform Trust Receipts Act had great appeal to largescale lenders, whereas local lenders against consumer goods and farm products argued for local filing since the debtors borrowing against them would likely be locals. Everyone seems to have agreed that filings against fixtures should be done in the real estate office locally. G. GILMORE, *supra* note 4, at 517. Apart from this, there was no accord on the matter, so "the section is drafted in a series of alternatives; local considerations of policy will determine the choice to be made." U.C.C. § 9-401 official comment 1.

Perfection and the effects of perfection in interstate secured transactions, on the other hand, are directly controlled by section 9-103. The general rule is that "perfection and the effect of perfection . . . are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected." U.C.C. § 9-103(1)(b). This "last event test" in interstate transactions has been the topic of much debate and raises issues and concerns closely allied with those raised by debtor name changes and collateral transfers. *See generally infra* note 47 and accompanying text.

32. U.C.C. § 9-403(4) (directs the filing officer to index the financing statement alphabetically according to the debtor's name).

33. *See supra* note 18. Section 9-312(5) assigns or denies priority to secured parties according to the time of filing, if perfection is by filing. U.C.C. § 9-312(5). This, together with the absence of any requirement that the earlier filer be without notice of the prior unperfected security interest, makes the basic Article 9 priority rule a race statute.

Claims to the collateral by judgment lien creditors, including the debtor's trustee, are sorted out by section 9-301. Section 9-310 governs claimants with liens arising by operation of law, including mechanics and materialmen liens. *Id.* §§ 9-301, -310.

34. It would probably be more accurate, if slightly less impressive, to say that the searcher who discovers the financing statement is on inquiry notice that there may be a security interest in the collateral. *See Id.* § 9-402 official comment 2; *see also infra* note 37.

system are fulfilled. It would be very difficult to decide which function is the most worthy of the two. Under these circumstances, however, it is the notice function that is brought to bold relief: a searching prospective creditor discovers the financing statement and decides to extend credit, or not, enlightened at least as to this aspect of his debtor's financial health.[35] On the principal that one should take subject to those interests of which there is notice,[36] a second-in-line creditor who extends in the face of a filed financing statement must accept the fact that the collateral will not be available to satisfy the obligation should the debtor default or become insolvent.[37]

Where the filing system does give notice in fact, it is easy to form the impression that the financing statement was conceived primarily to alert the

35. The status of the debtor's personalty is, on the other hand, only one indication of financial health, one fact to be considered in deciding whether or not to extend credit. Whether it is even an important fact may turn on the nature of the debtor, the potential creditor, and whether the transaction is to be secured or unsecured. *See infra* notes 96-99 and accompanying text.

36. This is not to suggest that a searcher's lack of knowledge of the perfected security interest is at all relevant: section 9-312(5) is a pure race statute. *See supra* note 18. Of course, this is a two-way street. For instance, if creditor A extends credit and takes a security interest, creditor B may extend credit to the same debtor, retain a security interest in the same collateral, and seize priority by filing first even if B actually knows of the prior—but as yet unperfected—security interest of A. U.C.C. § 9-312(5)(a); *see also id.* official comment 5. Professor Gilmore may not have been entirely convinced that the drafters intended the complete irrelevance of a searcher's knowledge because it amounts to a rather radical departure from pre-Code security law. *See generally* G. GILMORE, *supra* note 4, § 34.2, at 901. There are those who argue that knowledge would play some part in priority questions. *See, e.g.*, Felsenfeld, *Knowledge as a Factor in Determining Priorities Under the Uniform Commercial Code*, 42 N.Y.U. L. REV. 246 (1967). It also appears to be the case that the 1952 Official Draft recognized knowledge as significant in some matters of priority, but later drafts abandoned knowledge as a factor. *Id.* at 247-48 n.11.

There are a few instances in the Article where knowledge is material. For example, a financing statement filed in good faith in the wrong place is, nevertheless, effective to perfect a security interest in "collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement." U.C.C. § 9-401(2). Before concluding on the basis of this or other provisions, e.g., section 9-307(2), that seem to signify some limit upon the pure race approach of the Article, it should be noted that both provisions operate in favor of first filers. It would be safer to conclude that section 9-401(2) amounts to still another provision through which the drafters have smiled upon the perfected secured party. Professor Coogan says, "It can be argued that the Code has gone further than necessary to meet the legitimate needs of the parties [by drastically simplifying the filing requirements]. . . ." Coogan, *supra* note 27, at 319. Grant Gilmore acknowledges that the list of Article 9 provisions which liberalize security law and remove former restrictions on lenders' operations is a long list. GILMORE, *supra* note 3, at 34-35.

37. Once again, this may be matter of great moment to some, but of complete indifference to others. The argument has been made that the availability or unavailability of particular items of the debtor's personalty is inconsequential to unsecured creditors, whereas it is of great concern to secured creditors. *See* Baird, *supra* note 22, at 57; *see also infra* notes 96-99 and accompanying text.

world that some or all of the debtor's personalty is encumbered by an extant security interest, that the notice filing system has as its principal object the enlightenment and welfare of searching potential creditors.[38] This can probably be attributed to the fact that where the financing statement accurately identifies the debtor and is properly indexed and is, therefore, discoverable, the claim-staking function is automatically but quietly served as well. It is when matters are otherwise ordered, when a financing statement cannot be

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38. Indeed, there are trails which seem to lead to this conclusion, the most inviting of which may be official comment 2 to section 9-402 which states that the business of the financing statement is to do no more than indicate "merely that the secured party who has filed may have a security interest in the collateral described." U.C.C. § 9-402 official comment 2. The statement is highly provocative of the conclusion that the primary object of the notice filing system is the public notice function and it seems to have led some to that very conclusion. *See, e.g., In re* McBee (Nat'l Bank of Tex. v. West Tex. Wholesale Supply), 714 F.2d 1316 (5th Cir. 1983); *In re* Southern Properties (Richmond Fixture and Equip. Co. v. Hyman), 44 Bankr. 838 (E.D. Va. 1984); *In re* Thermal Barriers (Leech v. White), 8 Bankr. 294 (E.D. Mich. 1981); DG & Assoc., 9 Bankr. 94 (E.D. Tenn. 1981); *In re* Whirlpool Corp. v. Bank of Naperville, 97 Ill. App. 3d 139, 421 N.E.2d 1078 (1981); Greg Restaurant Equip. v. Valway, 144 Vt. 59, 472 A.2d 1241 (1984); Hastings Note, *supra* note 2, at 961 n.16.

Professor Coogan states "the real function of a filing or recording system . . . [is] . . . to give notice to other creditors of the actual or possible existence of security interests in personal property which appears to be owned by the debtor." Coogan, *supra* note 27, at 319. (With respect to the problem—real or imagined, contemporary or anachronistic—of the debtor's ostensible ownership of the collateral occasioned by his retaining possession, see *supra* note 23.) But Professor Coogan makes this observation in the context of his criticism of pre-Code filing rules with their slavish adherence to formalities which "made filing a ritual to be performed in a ritualistic manner." Coogan, *supra* note 27, at 319. The important point to be gathered from Professor Coogan's discussion is not so much that the public notice function is uppermost in the notice filing system of Article 9, but that "excessive regard for the old technicalities" resulted in formal requirements utterly without function that advanced no purpose. *Id.*

It is interesting to note that Professor Coogan's discussion of such matters centers around the concern he apparently felt at the time that the drafters of Article 9 may have gone too far in simplifying the filing requirements. He warns that technical compliance under the Article is so simple that secured parties might "defeat the purpose of the Code's filing system by giving so little information as to prevent it from performing the function it can legitimately be expected to perform. If the secured party thinks that compliance . . . is a matter of mere ritual . . . he could hardly complain if a court later insists" upon absolute precision in the matter of filing formalities. *Id.* To avoid this route back to the unhappy time when secured parties had to dance attendance upon excessive filing conventions, Coogan advises secured parties to provide as much information in the financing statement as is consistent with reasonable cost and convenience. *Id.* at 320. Professor Coogan's fears seem not to have been realized, at least not to any great extent, but it is doubtful this results from his admonition. In any case, to assign too much weight to the public notice function may lead to confusion over the priority and filing provisions called for by Article 9 in some cases. *See, e.g.,* Hastings Note, *supra* note 2, at 974 n.78.

found by searching the U.C.C. filings, that the importance of the claim-staking function of Article 9 becomes clear.

Inaccessible Financing Statements

Were it true that the notice filing system has as its primary or sole object to alert the world at large to the existence of perfected security interests, it might be supposed that disputes over collateral that arise when a financing statement fails to give notice would more often be resolved in favor of searchers unable to find it. In fact, whether the notice-giving function or the claim-staking function is granted hegemony when a financing statement is not disclosed by a search of the U.C.C. filings depends in large measure upon why it cannot be found and, perhaps, who is looking. Two cases in which a financing statement may fail to give notice of a security interest are those in which a debtor's name is changed after the financing statement is filed, and in which the debtor transfers the collateral to a third party after filing. These are the subject of section 9-402(7), one of the '72 Amendments to Article 9[39] which has been the subject of recent criticism.[40] What follows is an analysis of the name change and transfer cases as they are resolved by section 9-402(7).

Discussion of debtor name change and collateral transfer cases really must begin with what might be called debtor name error[41] cases. These are of two sorts. The first is the case in which the error is precipitated by the secured party who, in preparing the financing statement, fails correctly to identify his debtor. In the second kind of name error case, the financing statement, although impeccably prepared, is submitted to the filing officer who misindexes it.

The responsibility correctly to identify the debtor at the outset rests squarely upon the secured creditor who wishes to perfect the security interest.[42] Should the secured creditor fail in this particular, the financing state-

39. To date, section 9-402(7) has been adopted in 44 jurisdictions. *See* U.C.C., 1 U.L.A. 1-2 (Supp. 1986).

40. *See, e.g.*, Duncan & Lyons, *supra* note 6; Westbrook, *supra* note 2.

41. The relationship of the name error cases and name change cases was tacitly recognized, for instance, in *In re* McCoy, 330 F. Supp. 533 (D. Kan. 1971). Concluding, inter alia, that a secured creditor is not obliged to prove that its filed financing statement would give actual notice to inquiring creditors, the court reasoned that a contrary rule would permit searchers without actual notice to defeat the prior security interest because of an error committed by the filing officer. For more on filing officer errors, see *infra* notes 47 and 53.

42. Section 9-402(1) of the 1972 Code expressly requires the debtor's name, as well as the debtor's signature, to appear in the financing statement, but the 1962 Code required only the debtor's signature. Courts applying the 1962 Code had little trouble finding the debtor's name to be a requirement by implication. *See* Hastings Note, *supra* note 2, at 961 n.14 (collecting cases).

ment is said to be void ab initio, the security interest never perfected.[43] This security interest will be subordinate to all claims to the collateral that arise prior to correction through refiling, assuming correction is ever accomplished.[44] The reasons in support of the *ab initio* rule are not difficult to divine. At this stage of the transaction, the secured party has absolute control of the financing statement and is in the best position to ensure its accuracy. After all, it is the secured party who prepares it. Additionally, it is at this point in the transaction, at the time of its creation and perfection, that the more sophisticated representatives of the secured party, perhaps to include its legal representatives, are directly involved. Moreover, the quality of attention given the transaction by those representatives is apt to be elevated at this stage, owing to a desire to set things up properly at the outset.[45] In keeping with this state of affairs, the price for failure to prepare a financing statement which does not identify the debtor is non-perfection.[46]

It is one thing to insist that the financing statement correctly identify the debtor when prepared and to void it otherwise. It would be something else again to void a financing statement which, accurate when prepared, leaves the secured party's hands only to be misindexed by the filing officer to whom it is presented.[47] Certainly, it is of no moment to the searcher that

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43. This is the pronouncement of the so-called *ab initio* cases, holding that financing statements containing seriously misleading errors were ineffective to perfect from the time of their filing. *See* Duke Note, *supra* note 2, at 150-56 (discussing the *ab initio* cases in some detail).

44. U.C.C. § 9-312(5); *see supra* note 18 (discussing priorities).

45. These conditions are simply the opposite of those that are presumed to obtain after filing. *See infra* note 47 and accompanying text.

46. *See supra* note 43.

47. Strictly speaking, misindexing by the filing officer does not occur post filing. Nevertheless, it is treated as a post filing event which can render a financial statement undiscoverable by a routine search of the U.C.C. files. To put it in other terms, misindexing is one instance in which is raised the question, should the secured creditor be compelled to refile in the event something occurs to render the financing statement so misleading as not to be discoverable?

Another and related instance—and one that has been much debated—involves the movement of the collateral. Debtor borrows from Creditor to whom Debtor grants a security interest in equipment. Both Debtor and Creditor are residents of State A, so creditor promptly files a financing statement to perfect with the secretary of state for State A which has adopted the first alternative for section 9-401(1). Thereafter, Debtor moves to State B, taking with him the equipment which is the subject of the security interest held by Creditor. In the event Debtor seeks to borrow from Potential Creditor in the state of B, Potential Creditor will not, of course, discover Creditor's interest by searching the U.C.C. files under Debtor's name in the secretary of state's office for State B. Similarly, a change in the use of the collateral may create the same sort of problem for the searcher. For instance, Debtor borrows from Creditor to finance the purchase of a refrigerator for Debtor's personal use, granting to Creditor a security interest in the refrigerator. According to section 9-302(1)(d), Creditor's security interest is automatically perfected, provided the security interest is valid the filing officer instead of the secured party committed the error. The accurately prepared but misindexed financing statement is as misleading and difficult to discover. On the other hand, the participation of the secured party in the filing process is said to end at the filing desk, and with it the control over the document together with, perhaps, any real concern for its destiny. As these evaporate, they take with them any further responsibility on the part of the secured party. If it is properly prepared at the outset, the misindexed financing statement is effective to perfect the security interest, such that the risk of misindexing falls to the searcher.[48] The notice function is lost in practical subservience to the claim-staking function.

Somewhere between the *ab initio* cases, in which an inaccessible financing statement can be attributed to the pre-filing error of the secured party, and the misindexing cases, in which financing statements are lost to the

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under section 9-203. If Debtor thereafter begins to use the refrigerator in his restaurant business, it becomes equipment under section 9-109(2). Debtor then approaches Potential Creditor from whom Debtor secures credit on the strength of the refrigerator offered up to secure the loan. Potential Creditor, believing the refrigerator to be equipment and unaware it was ever anything else, searches the U.C.C. files and, of course, finds no financing statement to reflect Creditor's prior perfected security interest.

The fact is, there are many circumstances under which a security interest may be hidden from the searcher, some occasioned by the debtor, as with movement of the collateral or name changes, and some occasioned by the fact that Article 9 simply tolerates and sanctions certain hidden security interests from their inception. While some are discussed here in connection with the name change and collateral transfer problems, the reader is directed to McLaughlin, *"Seek But You May Not Find": Non-U.C.C. Recorded, Unrecorded and Hidden Security Interests Under Article 9 of the Uniform Commerical Code*, 53 FORDHAM L. REV. 953 (1985). In that article, Professor McLaughlin provides a thorough and cleverly organized catalog of hidden security interests tolerated by Article 9. While the policy considerations in favor of requiring the secured party to refile to avoid misleading the searcher may vary depending upon, for instance, whether the financing statement is undiscoverable because the collateral is moved out of state or the debtor has changed its name, the policies against a refiling rule are mainly fixed. Mr. Burke, in his excellent article, lists three policies:

> First, the Code's expressed policy is to test the filing requirements by the conditions that existed when the security interest was created and not by the debtor's subsequent conduct over which the secured creditor has no control. Second, under the 1966 text of article 9, there is no mechanism available to the secured creditor to permit a new financing statement to be filed where a name change occurs if the debtor will not cooperate by signing a new financing statement or an amendment to the stale financing statement. Third, a refiling requirement would impose an undue policy burden on a secured creditor, particulary where the credit extension does not involve continuing contact between the debtor and the secured creditor.

Burke, *supra* note 2, at 1085 (footnotes omitted).

48. *See, e.g.*, cases collected in J. WHITE & R. SUMMERS, *supra* note 10, at 951 n.198 and accompanying text. *See also infra* note 53.

system through the acts of a filing officer who is a complete stranger to the transaction, are those cases in which financing statements cannot be found because of post-filing conduct of the debtor.

Assume, for instance, that A & B, Inc. borrows from First Bank which takes a security interest in the corporation's equipment. First Bank prepares and files a financing statement listing A & B as debtor. Thereafter, A & B, Inc. changes its name to C & D Corporation, then endeavors to secure a loan from Second Bank to which it offers the already encumbered equipment as collateral. Needless to say, no amount of searching the filings under the name C & D Corporation will disclose to Second Bank the security interest granted by the corporation while it was still called A & B, Inc.[49] If, instead, after granting the security interest A & B, Inc. transfers its equipment to X, Y, & Z, Inc. (a distinct and unrelated entity),[50] a potential creditor of that transferee will not discover the security interest created by X, Y & Z's predecessor in title, A & B, Inc. from a search under the name X, Y & Z, Inc.

Both the above illustrations, the former a name change case, the latter a transfer case, are instances in which a financing statement has become misleading through post-filing conduct of the debtor. The name change and transfer cases are different from one another, and both are different from the name error cases in some respects. Nevertheless, all share in common an identical impact upon those who search the U.C.C. filings to learn whether a potential debtor's personalty is already the subject of a perfected security interest. That is to say, these cases represent a failure of the filing system to fulfill the public notice function and, therefore, raise the same fundamental question: who must suffer the consequences when a financing statement cannot be found by searching the U.C.C. filings? It is a question of deciding who, as between the prior secured party and the second-in-line creditor with-

49. For cases involving corporate name changes, see, for example, *In re* Bud Long Chevrolet, 39 Bankr. 499 (D.N.M. 1984); *In re* Tyler (Huntington Nat'l Bank v. Molded Plastics), 34 U.C.C. Rep. Serv. (Callaghan) 1428 (S.D. Fla. 1982); *In re* Thermal Barriers (Leech v. White), 8 Bankr. 294 (E.D. Mich. 1981); *In re* Icon Indus. (Official Creditor's Comm. of Icon Indus. v. Security Trust Co.), 10 Bankr. 693 (W.D.N.Y. 1981); Continental Oil Co. v. Citizens Trust and Sav. Bank, 397 Mich. 203, 244 N.W.2d 243 (1976). There are what might be called genuine name change cases in contrast with cases involving name changes accompanied by collateral transfer. *See, e.g.*, *In re* Grape Arbor, 6 U.C.C. Rep. Serv. (Callaghan) 632 (Bankr. E.D. Pa. 1969); *see also infra* notes 189, 196, and accompanying text.

50. *See, e.g.*, *In re* Matto's, Inc. (Matto's, Inc. v. Olde Colonie Place), 8 Bankr. 485 (E.D. Mich. 1981). Examples of third-party transfers uncluttered by some connection between the transferor and transferee are difficult to come by. Other instances of what might be classified as true third-party transfers of collateral include: *In re* Franchise Sys. (Loeb v. Franchise Distribs.), 46 Bankr. 158 (N.D. Ga. 1985), and *In re* Southern Properties (Richmond Fixture and Equip. Co. v. Hyman), 44 Bankr. 838 (E.D. Va. 1984).

out notice of the security interest, will have priority in the collateral.[51]

As noted, the reasons the drafters of Article 9 awarded priority to secured parties in the misindexing cases, but denied it to them in the *ab initio* cases, are readily extrapolated from the provisions themselves.[52] Again, these include escalated control, participation and interest of the secured party before filing, and their dissipation after filing.

The distinction between the *ab initio* cases on the one hand, and the misindexing cases on the other, which accounts for the dissipation of control and participation is, of course, the introduction in the misindexing cases of a random agency in the form of the filing officer. Article 9's absolution of the secured party from all responsibility for the effectiveness of the financing statement to give notice based on this distinction has received bland acceptance.[53] It is difficult to find commentary critical of the results that have always been called for by the Code in the *ab initio* and misindexing cases.[54] No one seems to be overly disturbed by the fact that the notice function is conceded when a financing statement is inaccessible owing to the vagaries of the filing office. It is therefore interesting to note that the name change and transfer cases have a very different history.[55] Post-filing debtor behavior in the form of name changes and transfers does not belong to the secured party any more than does the filing blunder committed in the misindexing cases. Both kinds of activity occur without the control and, in some instances, even the knowledge[56] of the secured party. If the absence of secured party par-

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51. This is the heart of the matter. Cast in broader terms, the choice is between the public notice function of the filing system, on the one hand, and the claim staking function on the other. *See supra* notes 21-22 and accompanying text. Professor Westbrook would state the question in terms of preferring secured creditors to unsecured creditors. *See* Westbrook, *supra* note 2, at 416.

52. *See supra* note 48 and accompanying text; *see also supra* note 45.

53. The typical case is *In re* Royal Elec. Corp, 485 F.2d 394 (3d Cir. 1973), in which the file clerk inadvertently filed the financing statement according to the secured party's name rather than the debtor's name as provided by section 9-403(1). Citing that section and comment 1 to section 9-407, the court concluded that the risk of filing officer error falls to the searcher. *Id.* at 397-98; *accord* J. WHITE & R. SUMMERS, *supra* note 10, at 951 n.198 (cases collected therein).

54. Nevertheless, the problems for the searchers are certainly no less serious for the fact that the area is settled. D. BAIRD & T. JACKSON, SECURITY INTERESTS IN PERSONAL PROPERTY 243-45 (1984) provides an interesting discussion of this issue and the difficult policy questions it raises.

55. There are no fewer than fifty pre-amendment and post-amendment cases involving name changes and collateral transfers. There is also disagreement over how effectively the drafters dealt with the problem in section 9-402(7). *See, e.g.*, Westbrook, *supra* note 2. There also remain a few unanswered questions after section 9-402(7). *See, e.g.*, *infra* text following note 188.

56. *See, e.g.*, *In re* Grape Arbor, 6 U.C.C. Rep. Serv. (Callaghan) 632 (Bankr. E.D. Pa. 1969) (discussed *infra* note 60); *In re* Granny Frannies, 39 Bankr. 377 (D.S.C. 1984) (secured creditor unaware of sale of collateral by debtor until debtor

ticipation and involvement is reason enough to justify the sacrifice of the notice function in the misindexing cases, it should be reason enough to award priority to the secured party notwithstanding that a financing statement is ineffective to give notice because of a debtor name change or transfer of the collateral. In fact, without express direction under the '62 Code, this is the resolution embraced almost uniformly by courts, albeit sometimes reluctantly.[57]

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petitioned for bankruptcy); Borg-Warner Acceptance Corp. v. Bank of Marin, 36 Cal. App. 3d 286, 111 Cal. Rptr. 361 (1973); Bank of Va.-Central v. Taurus Constr., 30 N.C. App. 220, 226 S.E.2d 685, *cert. denied*, 290 N.C. 659, 288 S.E.2d 450 (1976); *see also infra* text following note 149 (discussing secured party knowledge of post-filing activity and good faith).

57. *In re* Triple A Sugar (Maine Guar. Auth. v. Triple A Sugar Corp.), 3 Bankr. 240 (D. Me. 1980) is illustrative. In that case, the secured party knew of the debtor's name change but did not refile. The debtor in possession challenged the security interest, arguing the secured party was obliged to refile upon learning of the name change that rendered the financing statement misleading. Alternatively, the debtor in possession urged that the failure to refile amounted to commercial bad faith, citing *In re* Kalamazoo Steel Process (H.G. Burnett v. H.O.V. Corp.), 503 F.2d 1218 (6th Cir. 1974). For a complete discussion of this case and the "good faith exception," see *infra* note 149 and accompanying text.

In reaching its decision, the *Triple A* court concluded that the 1962 version of section 9-402 applied to the case. In the course of an opinion in which it grudgingly ruled for the secured party, the *Triple A* court stated: "The version of Maine Uniform Commercial Code § 9-402 governing the instant transaction imposed no statutory duty that a secured party cause the public record to reflect a debtor name change . . . ." *In re* Triple A Sugar, 3 Bankr. at 241. The court continued, "Since that time, the notice filing system has been further flawed by the enactment of . . . § 9-402(2)(d) expressly negating any such responsibility." *Id.* at 242 (footnote omitted) (Unlike section 9-402(7), the Maine counterpart to that provision does not contain a requirement for refiling as to collateral acquired more than four months after a debtor name change.) ME. REV. STAT. ANN. tit. *11*, § 9-402(2)(d) (Supp. 1986). 3 Bankr. at 242 (Footnote omitted). The opinion proceeds with a veritable indictment of the notice system. *Id.* at 242-44. The indictment is worth noting since it embodies most of the criticisms hurled at section 9-402(7) and echoes a judicial legacy of suspicion for non-possessory security. *See* Coogan, *supra* note 27, at 289.

The *Triple A* court noted:

> Notice filing is so uncomplicated from the standpoint of secured parties that the large volume of reported litigation over the simple requisites of a sufficient financing statement is surprising. The concomitant burdens on those forced to rely upon the public record are not inconsequential. Unless the skeletal information contemplated by § 9-402 is generously supplemented by the secured party, the burden of search may be heavy. Furthermore, the burden of further inquiry by the file searcher may be undertaken to no avail. These are inevitable and therefore, presumably, intended consequences of legislative adoption of notice filing. Beyond that, however, § 9-402 makes the searcher an indemnitor against "minor" errors of the secured party, a fact which has prompted this court to interpret its provisions with a view to the purposes of the Code filing system. Moreover, the searcher, not the secured party, bears the burden of indexing error by the filing officer, a

The '62 Code and the Name Change and Transfer Cases

The '62 Code has nothing to say about the viability of a financing statement which has become misleading through post-filing changes in the debtor's name or the debtor's transfer of the collateral to another.[58] It was therefore left to the courts to decide what impact, if any, such conduct was to have upon perfection. Almost without exception,[59] it was held that a secured party was under no obligation to refile, but continued perfected notwithstanding that a financing statement was ineffective to give notice because of a name change or collateral transfer.[60] This suggests an equation

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> fact which suggests the need for particular concern in circumstances where indexing correctly performed fails to reveal a financing statement under the name of the debtor due to error on the part of the secured party. The entire purpose of the Code filing system is to provide a reliable means by which to learn of the possible existence of consensual liens on property of the debtor. Judicial and legislative sympathy for errant secured parties has weakened important Code protections designed to ensure the notice opportunity upon which true notice filing depends. Yet there appears to be little legislative inclination to preserve essential notice-filing criteria even when Code simplism threatens to deprive the notice-filing system of any notice-giving utility whatever.

Triple A, 3 Bankr. at 242; *accord* Coogan, *supra* note 27, at 289.

58. Section 9-306(2) of the 1962 Code provides that a security interest survives the "sale, exchange or other disposition" of the collateral by the debtor unless "authorized." U.C.C. § 9-306(2) (1962). The provision presumably is a statement of continuing viability of the security interest notwithstanding transfer of the collateral, but does not speak to the question of whether the interest continues perfected, such that it is still entitled to priority over subsequent creditors. For a fuller discussion of section 9-306(2) and its place in the transfer issue, see *infra note* 175 and accompanying text; *see also infra* note 196.

59. The exception, however, is noteworthy. *See infra* text following note 149 on the good faith exception.

60. *In re* Grape Arbor, 6 U.C.C. Rep. Serv. (Callaghan) 632 (Bankr. E.D. Pa. 1969), an early oft-cited case, is illustrative. While its application for corporate name change was pending, The Grape Arbor, Inc. borrowed from Penn-Central National Bank, granting to the bank security interest in corporate furniture and other equipment. Unaware of the impending name change, the Bank perfected by filing a financing statement listing The Grape Arbor, Inc. as debtor. Upon the debtor's bankruptcy, the Bank petitioned for reclamation of the collateral securing the loan. The trustee resisted the petition, arguing that the security interest was invalid since, among other things, no new financing statement reflecting the debtor's name change had been filed.

The referee directed the surrender of the collateral, rejecting the trustee's contention that the debtor name change had invalidated the Bank's security interest. In so doing, the court observed that nothing in the Code requires refiling in the event the debtor's name is changed and that a contrary rule would permit the debtor to divest the secured party of the security interest through a clandestine name change. *Id.* at 633. Of course, the secret divestiture argument would offer no support to the no filing rule announced in this case had the Bank known of the debtor's name of a debtor's post-filing conduct with the independent conduct of the filing officer in the misindexing cases to arrive at the conclusion that a financing statement is unaffected by a debtor's name change or disposition of the collateral, but these '62 Code cases seldom go so far.[61] Instead, they are either based crudely on the fact that the '62 Code does not expressly require refiling under such circumstances,[62] or loosely on the notion that a debtor should not be capable of invalidating a security interest merely by adopting a different name or transferring the collateral.[63]

Two other observations are worth making here about the '62 Code cases. First, no distinction was made between name changes, on the one hand, and collateral transfers on the other, which, instead, appear to be regarded as

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change. Concerning the secured party's knowledge and its effect upon the question of continuing perfection, see generally *infra* text following note 149. The following articles give considerable attention to the name change and transfer cases decided under the 1962 Code: Burke, *supra* note 2 and Hastings Note, *supra* note 2.

Of course, not every jurisdiction has adopted section 9-402(7). *See supra* note 39.

61. The connection was recognized by implication, however, in Continental Oil Co. v. Citizens Sav. Bank, 57 Mich. App. 1, 225 N.W.2d 209 (1974), *aff'd*, 397 Mich. 203, 244 N.W.2d 243 (1976). There, it was argued that the secured party was obliged to refile upon learning of the debtor's name change, although the change occurred after the financing statement had been filed. The court distinguished *In re* Kalamazoo Steel Process (N.G. Burnett v. H.O.V. Corp.), 503 F.2d 1218 (6th Cir. 1974), which held that a secured party is so obliged when an impending debtor name change is known in advance of filing. The Michigan Court of Appeals observed, "We perceive . . . [*In re* Kalamazoo] to fall within the ab initio cases . . . ." *Id.* at 12, 225 N.W.2d at 214. This statement is highly suggestive that post-filing name changes fall within the misindexing cases.

62. *See, e.g., In re* Hammons (Fedders Fin. Corp. v. Borg-Warner Acceptance Corp.) 438 F. Supp. 1143 (S.D. Miss. 1977); *In re* Grape Arbor, 6 U.C.C. Rep. Serv. (Callaghan) 632 (Bankr. E.D. Pa. 1969); Continental Oil Co. v. Citizens Sav. Trust, 397 Mich 203, 244 N.W.2d 243 (1976).

"On the positive side in favor of . . . [the secured party], there is the provision [section 9-403(2)] that a filed financing statement is effective for five years from the date of filing . . . ." Borg-Warner Acceptance Corp. v. Bank of Marin, 36 Cal. App. 3d 286, 288, 111 Cal. Rptr. 361, 363 (1973). Some courts have regarded the very proposal of section 9-402(7) requiring the secured party to refile upon a debtor's name change as to some collateral as evidence that no such duty exists under the 1962 code. *E.g. Continental Oil Co.*, 57 Mich. App. 1, 225 N.W.2d 209; *In re* DG & Assoc., 9 Bankr. 94 (E.D. Tenn 1981). Other courts have expressed the notion that a legislative refusal to adopt section 9-402(7) amounted to a reaffirmation that the 1962 Code does not require refiling. *In re* Serrins Auto. Warehouse (AC-Celco Div. of Gen. Motors Corp. v. Serrins Auto. Warehouse), 18 Bankr. 718 (W.D. Pa. 1980) (citing cases at n.* p. 1421); *see, e.g. In re* Hammons (Fedders Fin. Cor. v. Borg-Warner Acceptance Corp.), 435 F.Supp 1143 (S.D. Miss. 1977); *In re* Hemminger, 20 Bankr. 357 (W.D. Pa. 1982) (citing *In re* Serrins).

63. *See, e.g., In re* Grape Arbor, 6 U.C.C. Rep. Serv. (Callaghan) 632 (Bankr. E.D. Pa. 1969); Inter Mountain Ass'n of Credit Men v. Villager, Inc., 527 P.2d 664 (Utah 1974).

presenting identical issues.[64] Next, what might be termed the "good faith exception"[65] was frequently argued by parties challenging the perfected status of a security interest and occasionally recognized by courts under the '62 Code.[66] In those few cases where it was recognized, the good faith exception was held under some circumstances to require that a secured party refile upon a debtor name change which rendered the earlier financing statement misleading[67] and undiscoverable by search of the U.C.C. filings.

64. *See* Hastings Note, *supra* note 2, at 966 & n.38; *see, e.g., In re* Kittyhawk Television Corp., 516 F.2d 24 (6th Cir. 1975).

65. *In re* Kalamazoo Steel Process, 503 F.2d 1218 (6th Cir. 1974) is the seminal case, holding that the section 1-203 obligation to deal in good faith may compel refiling under some circumstances. *See infra* notes 149-218 and accompanying text.

66. *See infra* notes 149-218 and accompanying text; *see, e.g., In re* Conger Printing Co., 18 U.C.C. Rep. Serv. (Callaghan) 224 (Bankr. D. Or. 1975); *accord* White Motor Credit Corp. v. Euclid Nat'l Bank, 63 Ohio Misc. 7, 409 N.E.2d 1063 (Ohio C.P. 1978), *aff'd*, 30 U.C.C. Rep. Serv. (Callaghan) 331 (Ohio App. 1980); *In re* DG & Assoc., 9 Bankr. 94 (E.D. Tenn. 1981).

67. U.C.C. § 9-402(5) (1962) excuses "minor errors" that are not "seriously misleading." *Id.* The neglected positive suggested is that errors which are seriously misleading may result in the failure of the financing statement to perfect the security interest. *See In re Kalamazoo*, 503 F.2d at 1221.

The question of whether an error in the debtor's name renders a financing statement seriously misleading is an intriguing one in its own right. It is raised in section 9-402(5) of the 1962 Code and in section 9-402(8) of the 1972 Code, which states that a financing statement is effective to perfect a security interest notwithstanding minor errors that are not seriously misleading. The object of section 9-402 is "to simplify formal requisites and filing requirements" and "to discourage that fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves." U.C.C. § 9-402 official comment 9. In this regard, see generally *supra* notes 27, 38, and accompanying text. The "seriously misleading" concept is expressly a part of the inquiry to be undertaken in cases of name change under section 9-402(7). Specifically, if a debtor name change does not render a financing statement (listing the old name) seriously misleading, the secured party is under no obligation to refile.

A few of the name change and name change-like cases decided under the 1962 Code were resolved on the determination that a debtor name change, or other post-filing debtor activity, did not render the financing statement seriously misleading. *In re* Kittyhawk Television Corp., 516 F.2d 24 (6th Cir. 1975), is illustrative. In that case, the Sixth Circuit concluded that a transfer of corporate assets from Kittyhawk Broadcasting Corporation (the debtor listed on the financing statement) to a successor entity called Kittyhawk Television Corporation did not render the original financing statement seriously misleading. The *Kittyhawk* court concluded that since the names were so similar before and after the post-filing conduct, a reasonably prudent searcher would not be misled by the change. *Id.* at 28-29. This suggests, of course, that the likelihood that a searcher will in fact discover the financing statement is the focus of the inquiry in deciding whether a post-filing change has rendered the financing statement seriously misleading.

On the other hand, it has been remarked that while the seriously misleading inquiry seems necessarily to be one that "raises the questions of knowledge and reliance of third parties" in keeping with *In re Kittyhawk* (and with White Motor

Name Changes and Transfers Under Section 9-402(7)

Just why the drafters of Article 9 neglected to address the issues of debtor name change and collateral transfers in the '62 Code is difficult to say. They had, after all, specifically addressed other issues of financing statement inaccessibility.[68] Be that as it may, the review committee[69] bent to the task in the '72 Amendments[70] to Article 9 to produce section 9-402(7) which provides:

> A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or names of partners. 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. A filed financing statement remains effective with respect to collat-

Credit Corp. v. Euclid Nat'l Bank, 30 U.C.C. Rep. Serv. (Callaghan) 331 (Ohio Ct. App. 1980) which follows the same reasoning), such matters are "contrary to the notice filing philosophy, which is not dependent on actual knowledge." *In re* Tyler, 34 U.C.C. Rep. Serv. (Callaghan) 1428, 1433 (S.D. Fla. 1982). The court in *In re* Tyler makes this point in the course of considering an intriguing problem. The name change in that case was from "Tri-State *Moulded* Plastics" to "Tri-State *Molded* Plastics." While it is difficult to imagine a more trivial change, the court notes, "if the recording officer's records are retrievable only by computer matching it may be unfeasible to locate any records except those filed under the absolutely identical name under which the search is made." *Id.* With the growing dependence upon the computer to perform quotidian tasks like the filing of financing statements, this problem will be an interesting one to watch for in the future.

68. *See, e.g., supra* note 47. The Sixth Circuit in *In re Kalamazoo*, 503 F.2d 1218, regarded it to be a matter of some significance that the drafters had made no provision for name changes and transfers of collateral while expressly providing that a financing statement continues perfected notwithstanding changes in, for instance, the debtor's residence or place of business. *Id.* at 1221. The implication seems to be that, had the drafters wished the interest to be unaffected by a seriously misleading name change, they would have so provided. It must be noted, however, that the Sixth Circuit was not willing to extend the good faith exception of *In re Kalamazoo* to cases where the secured party learned of the debtor name change *after* filing. *See In re Kittyhawk*, 516 F.2d 24; *accord In re* Gac, 11 U.C.C. Rep. Serv. (Callaghan) 412 (Bankr. W.D. Mich. 1972). For more on the matter of the secured party's knowledge of the debtor's post-filing activity and the good faith exception, see *infra* notes 149-218 and accompanying text. This raises some question about how convinced the Kalamazoo court was of its failure to provide argument.

69. Reference is to the Review Committee for Article 9, a creature of the Permanent Editorial Board for the Uniform Commercial Code.

70. For a discussion of the Amendments, see Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477 (1973).

eral transferred by the debtor even though the secured party knows of or consents to the transfer.[71]

At the outset, the provision gives separate treatment to the name change cases and the transfer cases, the second sentence being devoted to the former, and the third sentence to the latter. In this the provision is immediately distinguishable from the unitary treatment given the cases under the '62 Code.

Name Changes

Beginning with the second sentence of the provision, the Name Change clause, what precisely does section 9-402(7) do? Does it represent a departure from the '62 text of the Code or the case law interpreting the '62 Code in the context of debtor name changes? Is the provision consistent with what is known about the treatment Article 9 gives to similar inaccessibility cases, namely, the name error cases?

In answer to the first of these questions, the Name Change clause conclusively resolves two issues raised by post-filing debtor name changes. Whether a debtor name change renders a previously filed financing statement "seriously misleading" or not, a security interest continues perfected in collateral acquired by the debtor prior to, and within four months, after the change.[72] As to collateral acquired outside the four month grace period, the security interest is unperfected if the new name renders the financing statement seriously misleading, unless the secured party refiles under the new name. With respect to collateral acquired prior to and within four months after a debtor name change, section 9-402(7) is consistent with the cases which have made much of the silence of the '62 Code in refusing to impose a refiling obligation upon secured parties. In keeping with this case history, it is difficult to

71. U.C.C. § 9-402(7). Mr. Burke raises an interesting question with regard to the four month rule of section 9-402(7). The issue is

> [W]hether a secured creditor who becomes aware of a name change during the four month grace period and knows that his filing has become seriously misleading, has a duty to refile immediately . . . . If such a secured creditor delays filing until prior to the expiration of the grace period with the result that an intervening secured creditor is misled, can the intervening secured creditor argue that a duty to immediately refile has been breached?

Burke, *supra* note 2, at 1098. Mr. Burke continues by noting that such an argument might be based upon the good faith exception established in *In re* Kalamazoo, 503 F.2d 1218 (6th Cir. 1974) which, he asserts, may well not have been overruled by the adoption of section 9-402(7). At least one commentator believes this to be the case, arguing from the comment to section 9-402(7) that the secured party who acquires knowledge of the change within the grace period must refile. *See* Duke Note, *supra* note 2, at 159-60. *But see* Hastings note, *supra* note 2, at 982 n.16 (contending there is no support in the Code for such an argument). For more on the place of the good faith exception after section 9-402(7), see *infra* text beginning at note 161.

72. *But see supra* note 71 (a possible good faith limitation).

imagine that anyone would be surprised to learn that section 9-402(7) imposes no refiling duty upon secured parties which respect to collateral acquired prior to four months from the change in the debtor's name.

That the section would impose a refiling obligation with respect to collateral acquired outside the four month period is novel insofar as the case law on debtor name changes is concerned. Given that the absence of a refiling duty was inferred from the silence of the '62 Code there was no opportunity to carve out exceptions based strictly upon the point in time the debtor acquired the collateral within the reach of the security interest. In short, the Name Change clause of section 9-402(7) works a rather profound change on the '62 Code in the refiling mandate for post four month collateral,[73] but by definition the refiling obligation is necessarily limited to after-acquired property.[74] The security interest continues to be perfected as to all other collateral.

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73. On the other hand, some courts have stated that except for the four month rule, section 9-402(7) does not change prior law, but merely reaffirms the no duty to refile rule under the 1962 Code. *See In re* Granny Frannies, 39 Bankr. 377 (D.S.C. 1984) (citing Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982)).

74. Section 9-204(1) expressly permits what has been variously—and, occasionally, vituperously (see G. GILMORE, *supra* note 4, § 11.7, at 359)—described as the floating lien or lien in shifting stock. U.C.C. § 9-204 official comment 2. Allowing for the security interest in collateral the debtor has not yet acquired was no small matter. As the drafters note there was a judicial tradition of mistrust for the floating lien:

> The widespread nineteenth century prejudice against the floating charge was based on a feeling . . . that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved.
>
> . . . .
>
> This Article decisively rejects it [the "cushion" premise] not on the ground that it was wrong in policy but on the ground that it was not effective.

U.C.C. § 9-204 official comment 2. The comment goes on to describe the several means available to circumvent the rule against floating liens, such that in expressly validating the after-acquired property clause, section 9-204 does no more than acknowledge "an existing state of things." *Id.*

That Article 9 sanctions the after-acquired property interest, giving it "equal status with a security interest in collateral in which the debtor has rights at the time value is given (U.C.C. § 9-204 official comment 1) should not be taken as a pronouncement that the perfected security interest in after-acquired collateral is invariably—or even often—entitled to priority, at least over other perfected security interests. For instance, the after-acquired security interest may be subordinate to the purchase money security interest (see U.C.C. § 9-107) in the same collateral. U.C.C. § 9-312(5). This fact of priority gives substance to the statement in comment 2 quoted above that the drafters did not reject the policy that the debtor should not be in a position to "encumber all of his assets present and future." The subordination of the after-acquired interest to the purchase money security interest, for example, permits the debtor to borrow for the purchase of equipment necessary to the operation of his business, offering the equipment to secure the credit. Were the after-acquired security

The Name Change clause of section 9-402(7), then, distributes obligations between secured parties and searchers according to the nature of the collateral. A secured party has no duty to refile to continue the perfected status of the security interest in collateral acquired up to the end of the four month grace period,[75] and, therefore, has no monitoring duty to that extent. This necessarily implies an absolute duty upon searchers to discover even seriously misleading financing statements.[76] Of course, whether the security interest is discovered or not, the searcher who lends against this grace period collateral is not entitled to priority over the earlier perfected security interest. Discovery does no more than alert the searcher as to the condition of the debtor's personalty.

The Name Change clause is, then, a departure from pre-amendment cases so far as after acquired collateral is concerned. To the extent that the Name Change clause insists upon refiling to continue the perfected status of collateral acquired more than four months after a debtor name change [hereinafter post grace period collateral], it seems to represent a departure from the fundamental consideration in the misindexing and *ab initio* cases identified earlier — that the secured party should not be responsible to insure

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interest awarded priority in such cases, the debtor would be hard-pressed to obtain purchase money credit.

The point to note is that, while section 9-204 gives the security interest in after-acquired collateral equal status with security interests in collateral in which the debtor already has rights, the object of the equation is to make it clear that "the security interest in after-acquired collateral is not merely an equitable interest . . . ." U.C.C. § 9-204 official comment 1. There is that which survives the streamlining process of Article 9 where floating liens are concerned, namely, concern that the debtor may over-encumber, and this concern is reflected, in part, in certain priority limitations imposed upon the after-acquired property interest. *See infra* note 145 and accompanying text.

For an in-depth discussion of the pre-Code history of the floating lien, see G. GILMORE, *supra* note 4, § 8.1-.8, at 250-81. Professor Gilmore also discusses the floating lien under Article 9. *Id.* § 11.6-.7, at 254-365. For a discussion of the significance of the after-acquired property clause in connection with the four month refiling rule under section 9-402(7), see *infra* note 204 and accompanying text.

75. *But see supra* note 71. As to collateral acquired outside the four month grace period, the secured party must refile. Since nothing in section 9-402(7) or the comments thereto make any mention of the knowledge of the secured party, the refiling obligation translates into an absolute duty to discover the name change. *See In re* DG & Assoc., 9 Bankr. 94, 97 n.4 (E.D. Tenn. 1981); *see also infra* notes 170-73 and accompanying text (discussing the relationship of the refiling obligation to the discovery duty).

76. This is the analog to the discovery duty indirectly imposed on the secured party by the four month rule. *See supra* note 75.

So far as collateral transfers are concerned, the risk of non-discovery falls without exception to the searcher under the third sentence of section 9-402(7) (absent a judicially imposed good faith limitation. *See infra* text accompanying notes 149-218 (regarding good faith and transfers before and after section 9-402(7)). This means, for the searcher, a title search that must not fail.

the continuing effectiveness of the financing statement against the post-filing behavior of others. If the refiling requirement imposed by the Name Change clause does conflict with the Article's treatment of post-filing conduct in the misindexing cases, it stands to reason that the drafters regarded post-filing debtor conduct as somehow different from the conduct of filing officers, notwithstanding that the results are the same for the searcher in either case. There may be grounds for making that distinction,[77] but there is a more powerful explanation for the seeming contradiction, an explanation tied to theories of notice filing and secured credit financing, and to the nature of post grace period collateral itself. These considerations are the route to discovering why the public notice function is balanced away in some cases, the claim-staking function in others.

Notice Function, Claim-Staking and the Name Change Clause

There are doubtless many theoretical perspectives from which to discuss secured lending and notice filing. Two are considered here, namely, an economic approach,[78] and what might be characterized as the episodic approach.[79]

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77. That is, in some instances the secured party may have continuing contact with the debtor, and therefore a continuing awareness of the debtor's post-filing behavior. One commentator has so argued. *See* Levenberg, *Comments on Certain Proposed Amendments to Article 9 of the Uniform Commercial Code*, 56 MINN. L. REV. 117, 129 (1971). Whether this contact is anything more than the perfunctory attendance of paraprofessionals or clerks upon routine matters of handling remittances and the like is another matter. That is, the contact may not be significant so far as imparting information about the debtor to any representatives of the secured party able to recognize and act upon it. *See* Kripke, *Mr. Levenberg's Criticism of the Final Report of the Article 9 Review Committee: A Reply*, 56 MINN. L. REV. 805, 812 (1972). Professors Baird and Jackson, *supra* note 23, at 244, seem to suggest that no such distinction can be drawn on the basis mentioned in asking the following questions: "Even if the mistake [in indexing] is wholly the fault of the filing officer, the secured party . . . is not the only party potentially involved; subsequent secured parties who engage in a proper (but fruitless) search are also 'innocent.' These subsequent searches have no very effective way of discerning the filing officer's mistake. Is that true, however, of the original secured party? *Id.* (citation omitted).

Note, however, that not every filing officer error relieves the secured party of the consequences of misindexing. *See id.* (discussing Mikulicka v. Baer, 184 N.J. Super. 457, 446 A.2d 555 (1982), in which the secured party was estopped from asserting priority over a lender relying on the U.C.C. files).

78. There may be as many economic theoretical approaches as there are economists. The term here is used merely to distinguish it from what I have characterized as the episodic approach as discussed *infra* note 79.

In describing the economic approach—or perhaps more accurately, an economic approach to secured lending—I rely primarily upon my own amalgamation of the efforts of Professors Baird, Jackson, Schwartz, and a few others as indicated. This is not to suggest some sort of conspiracy among scholars who approach the Code

It has been argued, rather convincingly at times, that the filing system envisioned by Article 9 has little to do with the giving of notice to searching creditors, at least those not destined to become secured creditors.[80] This assertion proceeds from what might be described as conventional assumptions about the economics of secured credit. Fundamental among these is that secured credit is beneficial.[81] This, it is said, follows from the proposition that the costs to the commercial community of secured credit are more than offset by the advantages to be gained from it.[82] The advantages to the secured creditor include the reduced risk that the loan will not be repaid, given recourse to a specific category of collateral which might be seized to satisfy the obligation, and reduced monitoring costs.[83] Monitoring costs are reduced since the secured party is relieved of the onus of policing his debtor's post-transaction activities,[84] save only such debtor conduct as might bear on the

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from the perspective of the economist. Indeed, there is not complete agreement on the economics of secured lending. *See generally* Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Memories*, 10 J. LEGAL STUD. 7 (1981). It is suggested, on the other hand, that those named are among the most influential and visible scholars who currently write about such matters.

79. The term "experiential approach" or "practice approach" might as easily have been adopted here. The term episodic was selected because it was inspired by Professor Kripke's legal audit anecdote discussed *infra* note 108. Again, as with the term "economic approach," the principal object of referring to an episodic approach is to distinguish the two lines of thinking and influence. There is, in fact, a shrift between the two schools of thought. Battle lines seem to be forming around Professor Kripke and Professors Jackson and Schwartz. *Compare* Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929 (1985) *with* Jackson & Schwartz, *Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke*, 133 U. PA. L. REV. 987 (1985).

80. Baird, *supra* note 22, at 55.

81. It is a mistake to assume that the assertion is self-proving and conclusively resolved as a theoretical inquiry. Secured credit is a fact of commercial lending, but there is more than one attempt to explain its existence and its contribution to commercial credit. The discussion in the text attempts to present, albeit in somewhat generic and simplified terms, what can be regarded as a conventional law and economics explanation of the value and role of secured credit in commercial lending.

82. The discussion in the text on the economic justification for secured credit is an amalgamation of basic principles from the following articles to which the reader interested in further study along these lines is emphatically directed: Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979); and Schwartz, *supra* note 78. The reader should rid himself of any sense created by the discussion in the text that there is a unified or unitary economic theory of secured credit. The approach described, however, does represent a statement—if a very general one—of conventional thought in the area. *See, e.g.*, *infra* note 87.

83. An alternative to monitoring debtor behavior that might increase the riskiness of a loan is to insist upon more compensation for bearing the risk of nonpayment, for example, in the form of higher interest. Jackson & Kronman, *supra* note 82, at 1150. Presumably, this is what unsecured creditors have in mind.

84. This is an oversimplification, though accurate in substance. In fact, there

continuing availability of the collateral securing the loan.[85] Reduced secured party anxiety and policing costs are passed along to the debtor as lower interest rates.[86] Moreover, reduced risk of non-payment moves lenders to extend credit to borrowers who could not borrow without security,[87] for example, commercial borrowers beginning a new business.

On the other hand, as the risk of loss from non-payment and monitoring costs decline in favor of the secured party, there is a corresponding increase

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are other "costs" associated with the risk of debtor post-transaction behavior, as described by Jackson & Kronman, *supra* note 82 at 1151:

> In a credit transaction of any complexity, it is reasonable to think that creditors will engage in some monitoring themselves, will require their debtors to undertake some monitoring related responsibilities, and will also demand additional compensation for whatever risk of misbehavior remains after all cost-justified monitoring steps have been taken. Consequently there are three costs associated with the risk of debtor misbehavior: first, the cost of the creditor's monitoring activities; second, the cost of whatever monitoring the debtor undertakes himself; and finally, the cost of the increased compensation the creditor will demand for assuming any risk of misbehavior that cannot be eliminated by cost-justified monitoring. Both parties will have an incentive to arrange their transaction in a way that minimizes the sum of these three costs, since they can share any savings between them.

Id. at 1151 (citations omitted).

The economists also identify different kinds of risk than the risk of non-payment inherent in extending credit. Specifically, there is the risk of debtor misbehavior motivated by the fact that the interest rate for a loan is fixed:

> Because the interest rate is fixed, the debtor has an incentive to increase the riskiness of the loan, since by doing so, he effectively obtains a higher-risk loan at an interest rate reflecting the lower risk level anticipated by the creditor when the loan was made. By behaving in this way, the debtor gets something for nothing.

Id. at 1149.

The net effect of this kind of "debtor opportunism" described by Jackson and Kronman is the retroactive reduction of the interest rate charged the debtor. This is exemplified in the following scenario drawn by Schwartz.

> Recall that interest rates are partially a function of the risk of default, and that this risk is itself a function of the riskiness of the debtor's business. Suppose a firm borrows money at an interest rate that accurately reflects the risk of its enterprise. After the loan is made, the firm pursues a higher risk project for which a higher interest rate would have been charged. The firm has thus retroactively reduced the interest rate it faces; it is borrowing at a low risk rate for a high risk project. Firms with limited shareholder liability sometimes would so act because they would capture most of the gains if a high risk project pays off but bear only part of the losses if it does not. Creditors would bear the rest of these losses.

Schwartz, *supra* note 78, at 10.

85. Jackson & Kronman, *supra* note 82, at 1153; Schwartz, *supra* note 78, at 7; *see also* Baird, *supra* note 22, at 57.

86. *See* Jackson & Kronman, *supra* note 82, at 1148, 1153.

87. Schwartz, *supra* note 78, at 7 n.23 and accompanying text. Professor Schwartz is by no means convinced that the premises upon which the efficiency rationale are based have been sufficiently proved. *See id.* at 37.

in both to the unsecured creditor.[88] The risk that the unsecured obligation will not be satisfied increases to the extent that some or all of the debtor's personal assets have been placed outside the reach of the unsecured creditor by virtue of the security interest.[89] Since the value of the debtor's estate is reduced by the security interest,[90] the unsecured creditor must expand upon and elevate the level of his monitoring activities in other areas of the debtor's financial behavior.[91] The increased risk of nonpayment posed by the decreased value of the debtor's estate,[92] together with increased monitoring costs to the unsecured creditor, are reflected in the higher interest rate demanded for unsecured credit. Were it the case that the savings to the secured creditor corresponded exactly with the increased costs to the unsecured creditor, there could be no real economic justification for secured credit.[93] It is supposed, however, that there is a differential, that there is a net savings to the credit world which yields a benefit to all.[94]

What place does notice filing have in the economic paradigm? It has been suggested that, so far as the unsecured creditor is concerned, it has no place at all.[95] Unsecured lenders, it is said, rarely check the U.C.C. filings before deciding to extend credit.[96] Were they to do so, they would learn little

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88. Granting a security interest to one creditor reduces the debtor's worth at bankruptcy, and this knowledge is presumed to move the unsecured creditor to seek such protection as is available from higher compensation (i.e., higher interest rates) or other risk reducing actions. Unsecured creditors may, for instance, await a potential borrower who presents less risk of non-payment or misbehavior. *See* Jackson & Kronman, *supra* note 82, at 1147-48.

89. Schwartz, *supra* note 78, at 10; *see supra* note 88.

90. Schwartz, *supra* note 78, at 10.

91. It has been proposed, however, that in discouraging debtor misbehavior in general, secured credit reduces the costs of risk aversion for secured and unsecured creditors alike. *See Id.* at 11 (reviewing and questioning this idea as applied to short-term credit). Of course, it may be that security eliminates the risk of debtor misbehavior only as to the particular collateral that is encumbered, offering no advantage in reduced monitoring to the general creditor. *See* Jackson & Kronman, *supra* note 82, at 1153. What is more, "the very fact that someone is monitoring the property subject to the security interest may encourage the debtor to misbehave in ways that only affect other, less closely guarded, parts of the estate." *Id.* at 1153 n.41.

92. The general creditor may, of course, seek by contract to limit the debtor's capacity to diminish his estate through granting security interests.

93. "[I]n a world without monitoring or other transaction costs," the whole matter is a wash. Jackson & Kronman, *supra* note 82, at 1154. "[A]ny change in the interest rates charged by the two creditors [the unsecured and secured] should just offset one another and leave the total cost of credit to the debtor unchanged." *Id.* at 1155.

94. Thus, it is supposed that the decrease in costs to the secured creditor is greater than the increased costs to the unsecured creditor. Schwartz, *supra* note 78, at 10-11.

95. *See supra* note 80 and accompanying text; *see infra* note 97.

96. *See supra* note 80 and accompanying text; *see infra* note 97.

or nothing of value in reaching that decision.[97] As if this were not enough, whatever the status of the debtor's personalty when a search of the filings is done, there is little or nothing the unsecured creditor could do to prevent the debtor from thereafter granting a security interest encumbering all his personalty.[98] From this it follows that the inability to discover a financing statement lost to the system for any reason is a matter of no moment to unsecured creditors who rely, instead, on the general financial welfare of their debtors as revealed by other sources.[99]

If not to give notice to unsecured creditors, then, what is the object of notice filing? It is certainly not to give notice to the world at large.[100] Rather,

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97. Baird, *supra* note 22, at 60.

> Cases in which general creditors decide to lend because of their mistaken belief that an asset is unencumbered are rare. A security interest should not greatly affect a general creditor's assessment of the riskiness of his loan, because, as a general creditor, he does not look to a particular piece of property to satisfy the debt.

Id.

98. *Id.* at 61. It is unimaginable, however, that a general creditor would disregard the fact that his debtor's property was extensively encumbered in deciding whether or not to extend credit. That is, to the extent the state of a debtor's personalty is suggestive of his general financial health, this knowledge would be of some value to the general creditor. A general creditor's knowledge of, and reaction to, a security interest may play some role in the efficiency explanation of secured credit. This is explained by Professor Schwartz as follows:

> Security could be efficient in the Pareto-superior or Kaldor-Hicks sense. To perceive the difference, suppose that a security interest reduces the risks of a secured creditor by more than it increases the risks of unsecured creditors. Consider two cases. First, all creditors are aware of the existence of security; consequently, the secured creditor charges lower interest rates than it would have charged had it not taken security, and the unsecured creditors charge higher rates than they would have charged if no security existed. Since in this illustration the benefits of the interest rate reduction exceed the costs of the rate increases by assumption, security is (almost) Pareto-superior; the debtor and secured creditor are made better off by its existence while actual unsecured creditors are as well off as without security because they are paid to bear the increased risks that security imposes. Some risk-averse persons, however, may be discouraged from lending. Second, suppose that some unsecured creditors charge the same interest rates they would have charged had no secured debt been issued because they are too unsophisticated to react appropriately to security. In this case, secured debt makes these unsophisticated creditors worse off because their risks increase but they receive no additional compensation. Security would nevertheless be efficient in the Kaldor-Hicks sense. The gainers from security—the debtor and secured creditor—could compensate the losers—the unsophisticated creditors—and remain better off than without security, by the assumption that security reduces the risks of the secured party by more than it increases the risks of the unsecured creditors.

Schwartz, *supra* note 78, at 2 n.7 or 7 n.2.

99. *See supra* note 10 and accompanying text.

100. Baird, *supra* note 22, at 55; *see also id.* at 60. Many courts, however,

notice filing is a system which "sorts out property claims among those who have or seek property claims"[101] in the debtor's personalty. It is, in short, a system "where secured creditors stake claims to the debtor's property,"[102] and which resolves disputes over collateral "arising from competition between secured creditors."[103] If this is true, and if it is likewise true that secured credit is justifiable for the reasons given, there is every reason to streamline the filing system for the secured creditor,[104] further ensuring the net savings realized through secured lending. Accordingly, the financing statement is a bare-bones marker which does no more than announce the security interest,[105] and post-filing monitoring of the financing statement, the costs of which would erode the net savings realized, is definitely out. There are no monitoring costs associated with preparing a financing statement that correctly identifies the debtor in the first place, so that the results in the *ab initio* cases are perfectly acceptable. To insist that the secured party ensure the *continuing* accuracy of the financing statement in identifying the debtor after filing would be to introduce monitoring, hence, monitoring costs, into the transaction, thereby eroding the differential that justifies secured credit. In keeping with this idea, errors committed by the filing officer are left to searchers to discover, and the secured party has no policing or refiling duties under these circumstances.[106]

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routinely declare notice-giving to be the primary function of notice filing. *See generally supra* note 38.

101. Baird, *supra* note 22, at 55.

102. *Id.* at 62.

103. *Id.* at 66.

104. The greater the savings to the secured creditor, the greater the differential between the secured and unsecured lender. *See supra* notes 93-94 and accompanying text.

The streamlining of the recording system to the benefit of secured creditors is an express purpose of the Code's notice filing system. A purpose of the Code is to "simplify, clarify, and modernize the law governing commercial transactions," U.C.C. § 1-102(1)(a), and in keeping with this principle, the formal requirements for the financing statement are minimal. *See Id.* § 9-402 official comment 1. Indeed, it has been suggested that, perhaps, the Code has gone too far in the direction of abbreviated notice. *See supra* note 38.

105. [T]he document filed need only give notice to third persons that the one who is or expects to become a secured party is or may be claiming a security interest in some or all items of an indicated type of collateral owned or to be acquired by the debtor to secure a debt now outstanding or which might be incurred within the following five years.

Id. (citations omitted). "That is, the primary object of filing is to give the file searcher enough leads to permit him to learn more specific matters through his own inquiries." *Id.* at 318 n.100. It may be that even this modest assertion is an overstatement. *See supra* note 22 and accompanying text.

106. The result in the misindexing cases, however, raises an interesting question in the context of the foregoing economic analysis. Presumably, the result works no harm to unsecured creditors as this group is largely eliminated from the net savings

An episodic approach to Article 9, both the 1962 version and the 1972 amendments, takes into account what the drafters apparently believed about secured financing.[107] Of special concern here are the 1972 amendments, but

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calculus. Unsecured creditors never look for filing statements anyway. At the same time, the cost savings calculus must acknowledge a potential secured creditor's need to know the condition of his debtor's personalty offered as collateral. The net savings from secured credit is occasioned in part by the reduction in risk of non-payment, and the reduced risk of non-payment rests upon the notion that the obligation can be satisfied by recourse to the collateral. If the potential secured party cannot rely upon the filings to disclose a prior interest, the risk is always present that the collateral will not be available, that a prior secured party whose interest was not disclosed by the filings will later emerge to exercise a prior right in the collateral. Given this uncertainty, it would seeem that the net gain from secured financing would be reduced, manifested by a greater reluctance to lend and higher interest rates charged by the secured creditor. So far as the misindexing cases are concerned, it is impossible to say how the prospect that a prior interest might surface influences potential secured creditors because the result in such cases has been the same since the Code's inception.

It may be that the drafters did not believe the misindexing problem would occur with sufficient frequency as to inspire real alarm among secured creditors. It may be that section 9-403(1) had in mind to address the delay problems that arose in connection with chattel mortgage recording. *See* G. GILMORE, *supra* note 4, at 482 n.2. Whatever the thinking that initially prompted the imposition of the misindexing risk upon the searcher, it is eminently clear that it is the searcher who has it. *See supra* note 53 and accompanying text. The misindexing problem represents one example of inaccessibility where there seems to be little or no debate over the effect called for by the Code.

107. Of course, those involved with the drafting of the Code were scholars of the first order, but they were likewise men of practical experience. *See* G. GILMORE, *supra* note 4, at xi. In December, 1985, I had the very good fortune to meet with Professor Homer Kripke, who was kind enough to grant me an interview during an intermission in the meeting of the Article 9 Review Committee. Interview with Homer Kripke, Professor of Law, University of San Diego School of Law, in Philadelphia, Pa. (December 1985) [hereinafter Interview]. Of Professor Kripke's contribution to the drafting of Article 9, Professor Gilmore says: "His detailed knowledge of the practical operation of many types of financing arrangements furnished an invaluable source of necessary information . . . ." G. GILMORE, *supra* note 4, at xi. In the course of our interview, Professor Kripke confirmed that the driving considerations that led up to section 9-402(7) were emphatically functional ones, that the resolutions the provision prescribes in the name change and collateral transfer cases owe much to his first-hand observations of the marketplace, and his beliefs about the realities of secured lending. In discussing intrastate changes in location of the collateral and other changes of fact affecting the capacity of a financing statement to give notice, Professor Kripke has said:

> In general, my own approach to the balancing of conveniences was heavily influenced by a belief that there are comparatively few secured transactions which eventuate in a priority contest with another secured party. In particular, there are far more dealer transactions creating purchase money security interests than there are loan transactions on the same goods which occur while the purchase money transaction is extant. Therefore, a simple filing rule is preferable to a simple search rule. The latter would benefit only the

there is every reason to believe that the notice filing system embodied in Article 9 was conceived, above all, with reference to the real world experience of those who drafted it, the actual behavior of lenders,[108] secured and unsecured, in the marketplace.[109] To put it more philosophically, Article 9 may be more often descriptive than prescriptive.[110] Approaching the matter from this perspective, the inaccessible financing statement problem is seen in a somewhat different light. Certainly, it was of paramount importance to the drafters that the notice filing system be streamlined, simple and cheap. This was the object of notice filing.[111] In keeping with this object, post-filing monitoring obligations owed by secured parties are kept to a minimum. It cannot be concluded from this, however, that the drafters regarded these factors to be of such importance as to outweigh the notice giving function of the Code in all cases. While it is probable that the notice filing system

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relatively rare future hypothetical searcher.

Kripke, *The "Last Event" Test for Perfection of Security Interests Under Article 9 of the Uniform Commercial Code*, 50 N.Y.U. L. REV. 47, 64 (1975). The significance of these guiding beliefs is, in my own opinion, overlooked in criticisms aimed at section 9-402(7).

108. Professor Kripke makes the following declaration:

> Another reason for preferring a simple filing rule is that in the numerous dealer transactions the filings are routinely handled by secretaries or paraprofessionals, who could not be expected to adapt to complex rules requiring refilings under a last event test broadly applied. Nor could rules work well if they depended on knowledge of changed circumstances, for non-professional employees are not alert to changes of ownership from corporation to sole proprietorship or partnership, or to the possible significance of change of address or change of name on remittances by persons other than the named debtor.

Kripke, *supra* note 107, at 64 (citations omitted). By way of footnoting this statement, Professor Kripke tells us, "I learned this the hard way some years ago when I made a legal audit of the continued effectiveness of filings by a large secured creditor . . . ." *Id.* at 64 n.49.

Professor Kripke reiterated his belief that matters are still so ordered. Interview, *supra* note 107. The lack of continuing contact at a significant level—or, more importantly, perhaps, Professor Kripke's belief to that effect—is a powerful factor contributing to the distribution of benefits and burdens under section 9-402(7). Additionally, it is a factor which, in conjunction with others to be discussed presently, goes far in explaining away apparent inconsistencies in addressing points of criticism raised against the provision.

109. Professor Gilmore discusses the contributors to the Code effort in G. GILMORE, *supra* note 4, at x-xii.

110. This is not, of course, invariably the case. Section 1-203 requiring good faith, an obligation which, according to section 1-102(3) cannot be contracted away, is an example when it is not. *See* U.C.C. § 1-203. In requiring that a security party refile in some circumstances, it seems doubtful that section 9-402(7) is descriptive of secured creditor behavior generally. The idea of refiling to avoid the likelihood a searcher will be misled is not entirely novel, however. *See* McLaughlin, *supra* note 47, at 984 (discussing pre-Code law and filing errors).

111. *See supra* notes 27, 38.

was conceived and drafted on the presumption that its use and value to unsecured creditors is limited,[112] this is not to say that the the drafters regarded the filing system as a claim-staking mechanism designed largely to sort out priorities among secured creditors.[113] In other words, it cannot be stated with confidence that Article 9's draftsmen envisioned a world of secured financing in which secured parties stake their claims then compete among one another for priority which is invariably awarded the earlier filer, whose financing statement becomes misleading and undiscoverable, to ensure a net savings to the credit world.[114]

What is to be concluded from this discourse? In the context of the results called for by Article 9 in the misindexing cases, it can be argued that the notice function was not balanced away because no monitoring cost to the secured party could be tolerated, but because the drafters believed there are simply few or no second-in-line potential creditors to be misled.[115] If the drafters of the provision are correct in this, there is no justification for imposing any obligations upon secured parties to monitor, for example, the behavior of filing officers, the obligation would be incurred to no purpose.

The absence of a refiling obligation in the misindexing cases, then, is tied to considerations of the very real costs of monitoring that would attend that obligation as against hypothetical reliance searchers. That the problem engendering conduct in such cases belongs to the filing officer is incidental

112. *See supra* notes 22, 97 and accompanying text.

113. *See* Kripke, *supra* note 107, at 64. Professor Dunham, who became involved in the drafting of the Code early on, notes that, "[t]he primary reason for [accounts] filing is not to establish unencumbered titles, as in the case of realty records, but to give notice . . . ." Dunham, *Inventory and Accounts Receivable Financing*, 62 HARV. L. REV. 588, 610 (1949). *But see generally supra* note 22.

114. That conclusion flies in the face of some of the concessions the Article does make to the notice function. *See, e.g.*, U.C.C. § 9-103(1)(d) (requiring a refiling when collateral is moved interstate). Of course, there are many examples in Article 9 where a security interest is hidden, the risk of non-discovery falling to the searcher. *See generally* McLaughlin, *supra* note 47. *See also infra* note 115.

115. There is direct evidence of this from Professor Kripke's written commentary. Discussing, among other things, changes of location of collateral, he observes:

> [I]n these commercial law cases there are never a good guy and a bad guy, but rather two persons acting in good faith whose claims are nearly equally meritorious. It then becomes the draftsman's task to make a choice which will balance the convenience between the first secured party who wants a simple filing mechanism that he does not have to update all the time, *and a hypothesized future secured party who wants certainty and convenience in a rule which tells him where to to search the record.*

Kripke, *supra* note 107, at 63 (emphasis added). Professor Kripke reiterated this conviction in the course of our interview. Interview, *supra* note 107. This further indicates that, at least to the extent Professor Kripke's views are representative, the drafters did not view the notice-filing system as a battleground of priorities peopled by secured parties asserting priority in the same collateral. *See supra* note 108. *But see supra* note 22 and accompanying text.

to these considerations, not a moving consideration in itself. If this is true for the misindexing cases, is it likewise true for those parties who will be the actors in the scenarios arising under the Name Change clause and Transfer clause of section 9-402(7)? The actors still consist of the secured party and the searchers, and, for the most part, the effects of a monitoring obligation to the secured party remain the same under section 9-402(7) as in the misindexing cases. It is the impact upon the searchers in the shifting contexts envisioned by section 9-402(7) that is significant and different.

In the Context of Collateral Acquired by the Debtor Prior to a Name Change

It will be recalled that, so far as collateral acquired by the debtor up to four months after a name change is concerned, the Name Change clause imposes an absolute duty to discover upon searchers.[116] To assess the significance of foisting that duty upon them, it is necessary to consider the searchers themselves and how the drafters believed they behave. Generally, for these purposes, searchers may be said to occupy one of two categories: they are either potential unsecured creditors or potential secured creditors.

Beginning with this former category of searchers — the unsecured creditor—it may be that an absolute duty to discover is largely immaterial. As noted, it is at least arguable that unsecured creditors gain little that is useful in being informed of security interests and so, presumably, their decision to lend is reached without any real attention to UCC filings.[117] Besides, unsecured creditors charge a higher interest rate to offset the risks that attend unsecured lending, or so the economist view would have us believe.[118] Whether for these reasons or not, the drafters of section 9-402(7) likewise apparently believed that the filing system and, therefore, any deficiencies from which it might suffer, are matters of little consequence to unsecured creditors.[119] Accordingly, where in the course of bankruptcy proceedings it is asserted that an undiscoverable security interest was lurking behind a misleading financing statement resulting from a debtor name change, this non-relying group of creditors evokes little sympathy.[120]

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116. *See supra* note 71 and accompanying text.

117. The economic and episodic approaches are consistent in this. Professor Kripke likewise indicated during our meeting that he thought the filings were, at best, of indirect value to unsecured creditors. Interview, *supra* note 107. *See generally supra* note 97.

118. *See supra* note 88 and accompanying text.

119. *See supra* note 117.

120. Of the cases unearthed in preparing this article, the vast majority were instituted by a non-relying party, namely the debtor's trustee in bankruptcy or assignee for the benefit of creditors acting as hypothetical lien creditor per section 9-301(3) to defeat a security interest. *See, e.g., In re* Environmental Elec. Sys. (Almey v.

What of the searcher who lends against collateral acquired prior to the end of the four month grace period on the mistaken belief the collateral was

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Nikko Audio), 2 Bankr. 583 (N.D. Cal. 1980). This raises an important question: whether a challenge to the validity of a financing statement based on a debtor name change should be heard from any party who was not actually misled, a party who did not in fact rely? Respecting the cases decided under the 1962 code, the question is moot since, with few exceptions not relevant here (see *infra* text accompanying notes 149-218), courts uniformly held that the secured party was not obliged to refile no matter the nature of the challenger. Burke, *supra* note 2, at 1086. It is otherwise respecting section 9-402(7), which introduces a refiling obligation as to collateral acquired more than four months after a debtor name change. Under that provision a party need not have been misled, need not have relied: the duty upon the secured party to refile is absolute. U.C.C. § 9-402(7). This has the advantage of avoiding fact-laden inquiries, questions to be put to the challenging creditor such as whether he actually relied and, if so, was his reliance reasonable. It is simpler, at least on the face of it, merely to require refiling to continue the perfected status of a security interest in after-acquired collateral that comes to the debtor outside the grace period of the provision. Arguably, the straightforward rule is, in its simplicity, beneficial to the secured party whose refiling duty is directly stated.

On the other hand, notwithstanding that the refiling duty is cast in absolute terms, it must be recalled that refiling is only required when the debtor name change is "seriously misleading," a fact-laden inquiry if ever there was one. *See supra* note 67. Moreover, as one perceptive court has noted, the seriously misleading test insidiously forces upon us the very inquiry thought to have been put to rest by the absolute refiling rule:

> Inevitably, the reliance or lack of it by a third party and the knowledge of each party become considerations. Yet these are contrary to the notice filing philosophy, which is not dependent on actual knowledge.
>
> Where a name change occurs after an initially proper filing, there are further concerns. A secured party may be unaware of the change, and the unfairness of causing his disperfection again raises the questions of knowledge and reliance of third parties challenging the perfection. A prudent inquirer could learn of prior names, but should he have that burden?
>
> When the issue arises in bankruptcy, another dimension exists. Because the trustee has the position of a hypothetical lien creditor only, there is likely to be a bias toward the secured creditor, especially where the violation appears to be merely a technical one.

In re Tyler, 34 U.C.C. Rep. Serv. (Callaghan) 1428, 1433 (S.D. Fla. 1982); *see also supra* note 67 (regarding the seriously misleading test). The *Tyler* court does not labor long over the issue, however, concluding: "However, such a bias is not justified in view of the rights which were intentionally given to the trustee for the protection of all creditors." *Tyler*, 34 U.C.C. Rep. Serv. (Callaghan) at 1433. Of course, as a practical matter it would be absurd for a prior secured party to choose not to refile on discovering a debtor name change on the basis that the name might not be found seriously misleading. The question will likely arise only when for some reason the secured party failed to refile out of ignorance that the debtor's name has changed.

Whatever the realities might prove to be regarding the effectiveness of section 9-402(7) to avoid fact-laden inquiries ad hoc, the simplicity of the absolute refiling obligation was very likely one of the factors leading to the incorporation of the refiling duty into section 9-402(7). Another important factor related to the fact that the refiling duty is limited to after-acquired property, is discussed *infra* note 126 and unencumbered? This second-in-line secured creditor cuts a sad figure indeed. Having played by the rules, diligently searching under the debtor's name as of the time the new security interest was created, this secured party finds the interest junior to another that a customary search could never reveal.[121] Is this to say that the notice function of the filing system is simply balanced away, a mere incident of the real function of filing which is to provide a registry for claim staking?[122] If so, the possibility of subordination would seem to represent increased risk to secured creditors and increased anxiety over the prospect that when the sorting among security interests is done and priority awarded or denied, their security may be junior to that of another.

One might expect this increased anxiety to be reflected somehow, somewhere in the economic paradigm, perhaps in the form of increased reluctance to lend or higher interest rates for secured loans to offset the risk and greater costs of search and investigation incurred in an effort to reduce the risk of subordination. The effect upon the economics of secured lending would be an erosion of the savings differential which justified secured credit. The fact of the matter is there appears to be no empirical evidence that section 9-402(7), or the cases holding against searchers under the 1962 Code, has any of these effects. For that matter, there is a paucity of empirical information from which to conclude that secured lenders think along these lines at all.[123]

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accompanying text. *See also infra* note 125 (where the question of actual reliance on the files is taken up once again in another context).

121. The allegory of the innocent relying party is the basis for some criticism of the provision, but its place in the scheme of things as envisioned by section 9-402(7) is likely very limited. *See supra* note 108; *see also supra* note 115.

122. Once again, the term is used here in, perhaps, a broader sense than it is used by Baird. *See supra* note 22. In particular, in referring to the claim staking function I wish to avoid the suggestion that the notice filing system of Article 9 is a system designed to resolve priority disputes among secured creditors. *See supra* notes 107 and 115.

123. Though I disagree with some of the criticisms Professor Westbrook aims at section 9-402(7) in his article, he makes several well-considered and important points. *See* Westbrook, *supra* note 2. Chief among them is the indirect call for empirical information regarding commercial lending. Having asserted his disagreement with the complete absence of a refiling duty upon a transfer of collateral, Professor Westbrook observes: "It is difficult to say what period of time should be allowed for refiling after equipment transfers, especially when the secured party is unaware of the transfer. This problem presents an occasion in which the law could benefit from empirical study of industry and experiences." *Id.* at 416 (footnote omitted).

In his footnote 37, Professor Westbrook explains:

> Questionnaires to secured lenders and granters of unsecured credit could inquire about the evaluation of assets, customs regarding blanket equipment liens, and experience with selling equipment under lien. This technique of talking to the people involved in the regulated business was used in the creation of much of the original U.C.C.

Id. at 416 n. 37 (citation omitted). The quoted material is important in another regard, namely, the nature of Professor Westbrook's disagreement with the section 9-402(7)

So far as the drafters of section 9-402(7) were concerned, it appears more likely that the basis for the decision to relieve the secured party of any monitoring duty as to grace period collateral, and implicitly impose an absolute discovery duty upon searchers, is the same which dictates that result in the misindexing cases. In the opinion of one drafter, at least, there are simply so few potential secured parties who wish to create a security interest in the kind of collateral in question that secured party monitoring is not justified.[124] Absent searchers, there is no real sacrifice of the notice function, a function without a purpose to be fulfilled under these circumstances. In short, the only measure of the failure of the notice function is the presence of someone relying upon the system to give notice, since the notice function of the filing system cannot be said to fail without disappointed searchers.[125] Given this, it makes no sense to require anything of secured parties that might increase the cost of secured credit.

Collateral Acquired by the Debtor Outside the Grace Period: the Duty to Refile

How, then, can the new requirement to refile as to post-grace period collateral be justified? If the post-filing name change cases are quite like the misindexing cases, (both resulting from post-filing behavior beyond the control of the secured party, neither really affecting any but hypothetical searchers), why demand that the secured party monitor the debtor's post-filing behavior in the form of name changes based upon classification of the collateral? It can only be that the security interest in after-acquired collateral raises some difficulty uniquely its own,[126] or that the security interest in after-

resolution of the name change and collateral transfer issues.

The problem of a lack of empirical data in the area generally is not a new one. Discussing the reasons for filing to give notice, Professor Dunham, writing in 1949, laments that while some assumptions about the usefulness of public notice to creditors are susceptible to objective proof, no one seems to have bothered to go about gathering it up in a comprehensive way. Dunham, *supra* note 113, at 611.

124. *See supra* note 107. Inventory and accounts receivable financing, on the other hand, were expected to be big business. *See generally supra* note 5.

125. This remark admittedly suggests that a case-by-case, ad hoc inquiry into the matter of searcher reliance is called for, or is at least justifiable. It is not intended to go that far. *See generally infra* note 173 and accompanying text.

It is interesting to consider that a factual inquiry is prompted whether the focus is on the searcher, in which case the fact question is one of reliance, or the secured party, in which case the fact question is one of knowledge of post-filing activity. *See infra* notes 149-218 and accompanying text.

126. Actually, it might also be the case that, if there are thought to be none but hypothetical lenders against a debtor's fixed assets, it is otherwise as to dynamic collateral such as inventory and accounts. Once again, there is a disappointing paucity of empirical data on which to decide the question. There is reason to suppose that Professor Kripke, at least, believed second-in-line lenders against fixed assets who are misled by debtor name changes are rare.

acquired collateral is inherently different from that in a debtor's on-hand assets.

There is little in the other provisions and rules on creation and perfection that would lead us to expect after-acquired property to be treated differently by the drafters in section 9-402(7).[127] On the other hand, a look behind those rules, past Article 9 to the development of security in after-acquired collateral, discloses a troubled history. Security interests in a debtor's after-acquired collateral, the so-called "floating lien",[128] was reviled as a debtor's attempt to convey away something he didn't have.[129]

Where the after-acquired collateral was a debtor's rolling stock,[130] the floating lien was held in still lower esteem, since it not only suffered the infirmities of floating liens generally, it also "smelled of Twyne's case"[131]

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127. A filed financing statement perfects the security interest in after-acquired property in the same manner and to the same extent as it perfects the security interest in collateral in which the debtor already has rights. U.C.C. § 9-302(1)(a). Section 9-204(1) expressly sanctions the creation of a security interest in after-acquired property by its provision for an after-acquired property clause in the security agreement. *Id.* § 9-204(1).

128. Professor Gilmore reduces the traditional pre-Code arguments against the floating lien to two: First, the lien which floats over a debtor's property yet to be acquired will leave nothing available with which unsecured creditors might satisfy their claims in the event of the debtor's insolvency; second, to sanction the floating lien would be to fail to protect the debtor, who could encumber all that he might ever own, from himself. G. GILMORE, *supra* note 4, § 11.7, at 360.

129. The maxim is *qui non habet, ille non dat,* and is discussed *id.* § 7.10 n.1.

130. In Article 9 parlance, the debtor's rolling stock is a category of "goods" which are "held by a person who holds them for sale." U.C.C. § 9-109(4).

The history and development of security that depends upon inventory has particular relevance to the discussion of section 9-402(7). It would similarly be worthwhile to discuss receivables financing in the same context, but space does not permit it. This is by no means to suggest that important parallels do not exist or are not worthy of consideration in the matter of debtor name changes.

In any case, inventory financing deserves to be singled out for the simple reason that according to the priority rules of Article 9, second-in-line secured parties who extend credit so that a debtor might acquire, for example, new equipment will prevail in a dispute with a prior secured party claiming the same collateral on the strength of an after-acquired collateral clause. *Id.* § 9-312(4). To this purchase money secured lender (see section 9-107) it is of little consequence that an earlier filing has become misleading because of a debtor's name change. The subsequent secured lender against this same equipment is left out of the accounting for reasons already discussed. *See supra* note 107 and accompanying text. This leaves, as a practical matter and for our purposes, the secured creditor lending against inventory. *See infra* note 145.

131. Dunham, *supra* note 113, at 591. The reference is to the decision in *Twyne's Case*, 3 Co. Rep. 806, 76 Eng. Rep. 809 (Star Chamber 1601), in which the debtor secretly transferred ownership of his goods and sheep to one of his creditors in payment of an antecedent debt. The conveyance of ownership was held to be fraudulent because the debtor retained possession of the collateral.

Twyne's Case is perhaps the earliest judicial expression of the ostensible own-and sported a few unattractive traits of its own.[132] Inventory, that is to say specific items of inventory, passes through the debtor's hands into those of a buyer, the debtor taking in return proceeds of one kind or another.[133] As a result, the danger existed the debtor might abscond with the proceeds. For this reason pre-Code forms of inventory financing, of which there appears to have been an alarming array,[134] had to be "self-liquidating,"[135] and attached only to particular items of inventory.[136]

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ership problem. The basic principal is that to lend against collateral over which the debtor retains dominion and control is to cloak the debtor in a mantle of apparent ownership, a mantle with which a debtor so disposed might dupe others into extending credit on the mistaken belief the debtor holds the personalty free and clear. *See generally* Baird, *supra* note 22. For an in-depth discussion of the case in the historical context of the chattel mortgage, related matters, and subsequent cases, see G. GILMORE, *supra* note 4, at 24-61.

132. The traditional low regard for inventory financing grew, as well, out of the very nature of inventory itself: it is necessarily dynamic; individual items of inventory are by definition temporary. Professor Dunham writes:

> When a manufacturer or dealer gives security in his working assets—his inventory or his accounts receivable—he is giving security in property with which he cannot help but deal so as to destroy that security. For the lender's protection, therefore, the borrower must be required either to pay the loan at the time he disposes of the original security or to substitute other assets as the security.

Dunham, *supra* note 113, at 89.

133. Proceeds under section 9-306(1) are "whatever is received upon the sale . . . of collateral . . . ." U.C.C. § 9-306(1). Proceeds may be cash or non-cash proceeds including, for example, a debtor's accounts receivable. A security agreement by which a secured party acquires a security interest in the collateral automatically gives the secured party rights in the proceeds from the disposition of the collateral (§ 9-203(3)), and the security interest continues in the collateral as well. *Id.* § 9-306(2). Where the secured party takes the necessary steps, the interest in identifiable proceeds continues perfected, assuming the security interest in the original collateral was perfected. *Id.* § 9-306(3).

134. *See* Dunham, *supra* note 113, at 592, 599.

135. Dunham notes, "[t]he basic theme running through all inventory financing is that the lender is to be paid at a designated point in the course of the borrower's disposition . . . of the goods." *Id.* at 594-95. Where the common law permitted inventory financing in one form or another, it made the compromise where the inventory arrangement was self-liquidating, i.e., where the debtor accounted to the lender by turning over the proceeds upon disposition of the collateral. *Id.* at 595.

136. The floating lien contemplated that as specific items were sold out of the debtor's inventory, the debtor was to account for the proceeds to the lender. The floating lien did not attach to newly arrived items of inventory since it did not float over the category, inventory, but crudely and concretely attached itself only to specific items in existence at the creation of the interest. Thus, as the inventory dissipated, so went the security to be supplanted by proceeds which the lender collected and promptly applied in reduction of the indebtedness. This self-liquidating feature, therefore, necessitated close monitoring of the collateral by the lender. *Id.* at 593.

The English "floating charge" differed from the floating lien which, if it ever really floated at all, ceased to do so upon encountering items of inventory at rest.

While many pre-Code courts only grudgingly allowed the floating lien in inventory,[137] that the device persisted stubbornly in one form or another nevertheless is testimony to its commercial usefulness. The drafters of Article 9 having obviously recognized both its utility and that, however distasteful in theory, inventory financing was very much a matter of practice,[138] boldly[139] provided for after-acquired collateral in general,[140] and inventory financing in particular.[141]

Given the utility and reality of the after-acquired property clause and of inventory and receivables[142] financing, it is no great surprise to find these forms in Article 9. In keeping with the simplification dictate that is the watchword of the Article,[143] neither is it particularly surprising that the rules for creation and perfection with respect to such collateral do not suggest the controversial origins of the erstwhile mistrusted forms. It would be a mistake,

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The floating charge did not require the debtor to account for individual items of inventory by surrendering the proceeds of a sale to be applied instantly to the loan. Instead, the floating charge acknowledged that inventory as a category of collateral was of its very nature dynamic. *Id.* at 595.

137. Courts thought to be kindly disposed to inventory security held that such arrangements merely raised a rebuttable presumption of fraud. *See id.* at 590.

138. Professor Gilmore summarizes as follows:

> With respect to chattels (except for the special case of inventory) . . ., by the end of the nineteenth century, the after-acquired property clause had been recognized as effective to give the mortgagee what we would now call a perfected interest in new property as it might be acquired by the mortgagor.

G. GILMORE, *supra* note 4, at 354. He continues, "[t]he Article 9 draftsmen read their history to say that, in fact, the after-acquired property interest . . . was here to stay." *Id.* at 355. However, Gilmore writes, "[t]his aspect of Article 9 is its most controversial feature." *Id.* at 359.

139. Professor Coogan once noted, "[a]lmost all critics of Article 9 agree that its abolition of differences between the various security devices . . . is a great contribution to the law of personal property security. Practically all of the controversy centers around its so-called 'floating lien.' " Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838, 850 (1959).

140. Section 9-204(1) permits security interests in after-acquired collateral. U.C.C. § 9-204(1).

141. Inventory is simply a kind of goods within section 9-109(4). Receivables are brought within the ambit of Article 9 by definition under section 9-102(1)(a) and (b). *Id.* § 9-102(1)(a)-(b).

142. For a detailed discussion of accounts receivable financing, beginning with the seminal case, Benedict v. Ratner, 268 U.S. 353 (1925) through the express abolition of the rule of that case in Article 9, see G. GILMORE, *supra* note 4, §§ 8.1-.8, 11.6. There are many parallels between inventory financing and receivables financing, both in their history and evolution and in the problems the two kinds of financing traditionally were thought to create. *See* Kripke, *supra* note 5.

143. An underlying purpose of the Code is "to simplify, clarify and modernize the law governing commercial transactions." U.C.C. § 1-102(2)(a); *see also supra* note 29 and accompanying text.

however, to assume that the uniform treatment of inventory security in the filing rules reflects a lack of concern for the historical misgivings over floating liens generally and inventory security in particular, or that these were glibly swept away as merely quaint. If the historical "divorcement"[144] of a debtor's fixed, on-hand assets from inventory is not evident from the rules of perfection, it is evident elsewhere in the article.[145] The impression that inventory is like other goods follows more from the unitary system for creating and perfecting security interests than from a conscious decision that the kinds of security are in a practical sense alike.[146] Notwithstanding unitary treatment given inventory and other goods security by Article 9 in creation and perfection, security in after-acquired collateral and inventory, for all that, looks suspiciously like a series of separate security interests that accumulate as individual items of inventory move in and out of the debtor's hands and which require but a single filing to perfect.[147]

The conclusion urged here is that the duty to refile under section 9-402(7) as to after-acquired collateral is tied closely to the long divorcement between fixed assets and after-acquired collateral. Put another way, there is

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144. G. GILMORE, *supra* note 4, at 358-59.

> The long divorcement between financing on the security of fixed assets and financing on the security of a changing mass of inventory or receivables need no longer endure: everything, past, present, and future, tangible and intangible, can be swept up into one big security interest under one big security agreement.

Id. (citations omitted). The "long divorcement" Professor Gilmore refers to is discussed at *id.* § 8.1

145. Section 9-312(3) grants priority to purchase money secured lenders against an earlier perfected party in inventory provided the subsequent lender notifies the earlier filer. U.C.C. § 9-312(3).

The notification requirement naturally assumes the subsequent secured party has knowledge of the prior security interest. The notification requirement prevents the fraud-minded debtor from double-dipping, from taking an advance on incoming inventory from one (prior) inventory secured party having already granted a purchase money security interest in the same inventory to another and subsequent secured party. If the first secured party is notified by the second, it is presumed the advance will not be made. *See* J. WHITE & R. SUMMERS, *supra* note 10, at 1047-48 (discussing comments to section 9-312(3)). The notification requirement—which, again, presupposes knowledge of the prior interest—is another example of assigning the risk that the financing statement might, for some reason, be lost to search. It assumes an ability to discover the statement and, perhaps, favors the more sophisticated lender in this respect. *See generally supra* note 98 (citing Schwartz, *supra* note 78). The refiling rule of section 9-402(7) seems to offset or redistribute the risk of not finding a financing statement due to a debtor name change back to the prior secured party where inventory financing is concerned. *Cf.* U.C.C. § 9-402(7) (the collateral transfer clause).

146. It must be conceded, however, that there may not have been complete agreement among the drafters on this score. *See* Kripke, *supra* note 107, at 62 & n.45.

147. *See id.*

reason to believe section 9-402(7) treats after-acquired collateral differently because such collateral is implicitly different.

Name Changes and The "Good Faith" Exception

While the pre-amendment cases almost uniformly found nothing in Article 9 that would render a security interest unperfected for the secured party's failure to police a debtor's post-filing activity and refile upon discovering a change in the debtor's name,[148] there is a notable exception to the rule. The exception appears to have been announced for the first time in *In re Kalamazoo Steel Process, Inc.*[149] There, the debtor, Roman Industries Corporation, purchased equipment from Kalamazoo Process which apparently financed the purchase, retaining a security interest in the equipment sold. At the time the security agreement was executed, both parties anticipated that Kalamazoo Process would change its name to H.O.U. Corporation, and that Roman Industries would adopt the name Kalamazoo Process. In fact, the security agreement expressly stated as much. A financing statement listing Roman Industries as debtor was filed, and thereafter both parties amended their corporate charters to reflect the contemplated name changes. When Roman Industries/Kalamazoo Process filed its petition in bankruptcy, the trustee challenged the H.O.U. security interest, arguing that H.O.U. lost its perfected status when it failed to refile after the name change. H.O.U. responded, of course, that under the '62 Code it owed no duty to refile.[150]

The Sixth Circuit agreed with the trustee that H.O.U.'s security interest became unperfected, holding that H.O.U. acted in bad faith[151] when it failed to refile knowing at the time the security interest was created that the debtor planned to change its name.[152] Interestingly, the court observed that its hold-

148. Few courts have required refiling after a debtor name change or transfer of collateral. *E.g., In re* Kalamazoo Steel Process (Burnett v. H.O.V. Corp.), 503 F.2d 1218 (6th Cir. 1974); *In re* White, 51 Bankr. 514 (E.D. Tenn. 1985); *In re* D & G Assocs., 9 Bankr. 94 (E.D. Tenn. 1981). In cases involving a transfer of encumbered inventory, very few courts have bothered to distinguish items of inventory originally in the debtor's hands and actually transferred from items of inventory independently acquired thereafter by the debtor's transferee. *E.g.*, Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982); *see also infra* note 156.

149. *In re Kalamazoo Steel*, 503 F.2d 1218.

150. *Kalamazoo Steel*, 503 F.2d 1218, relied on *In re* Grape Arbor, 6 U.C.C. Rep. Serv. 632 (Callaghan) (Bankr. E.D. Pa. 1969) and *In re* Gac, 11 U.C.C. Rep. Serv. 412 (Callaghan) (Bankr. W.D. Mich. 1972). *Kalamazoo Steel*, 503 F.2d at 1222.

151. The relevant Code provision is section 1-203, which requires good faith in the performance of "[e]very contract or duty within this Act." U.C.C. § 1-203. Good faith is defined in section 1-201(19) to mean "honesty in fact in the conduct or transaction concerned." *Id.* 1-201(19).

152. It was the secured creditor's advance knowledge of the impending name change, according to the *Kalamazoo Steel* court, that distinguished the case from *In re* Grape Arbor and *In re* Gac. *Kalamazoo Steel*, 503 F.2d at 1222.

ing imposed no policing burden upon secured creditors in the position of H.O.U. since knowledge of the change was had in advance of filing.[153] In arriving at this conclusion, the court acknowledged that a routine search of corporate records on file with the secretary of state would have disclosed the name change, thereby opening the way to finding the financing statement, but this did not relieve H.O.U. of its refiling obligation. Even that very slight burden upon searchers was not justified given that the misleading financing statement could have been either corrected or prepared with an eye toward the change with no attendant burden upon H.O.U.[154]

On the other hand, what if the secured party acquires actual knowledge of a debtor's name change after filing? Is the failure to refile any less an act of bad faith under these circumstances? Apparently so. The Michigan Supreme Court in *Continental Oil Co. v. Citizens Trust*[155] refused to apply the good faith exception to such cases.[156] Citizens Trust held a perfected security interest in the inventory, proceeds and accounts receivable of South Haven Fruit Exchange. Sometime after the interest was perfected by filing, South Haven changed its name to Blossom Trail Growers. Continental supplied Blossom with inventory in which it perfected a security interest, filing a financing statement listing Blossom as debtor. In an ensuing dispute over the collateral, Continental urged that Citizens' security interest became unperfected after the debtor's name change. Continental argued that knowledge of the change was imputable to Citizens,[157] one of whose officers also served as director and treasurer of the debtor, and that Citizens' failure to refile was an act of bad faith such as occurred in *Kalamazoo Process*.

Continental's argument was rejected and *Kalamazoo* distinguished on the basis of the fact that the secured party in *Kalamazoo* knew of the name

153. *Id.*

154. *Id.* at 1223. ("[T]he original financing statement could be drafted to indicate the contemplated change with the result that it could be indexed under both names.").

155. 397 Mich. 203, 244 N.W.2d 243 (1976).

156. For that matter, the Sixth Circuit, one year after its decision in *Kalamazoo Steel*, refused to extend the good faith exception to require refiling where knowledge of the debtor's name change came to the secured party after filing. *In re* Kittyhawk Television Corp. (Corwin v. R.C.A. Corp.), 516 F.2d 24 (6th Cir. 1975). Mr. Burke has pointed out that *Kittyhawk* was not really a name change case at all, but in fact involved a transfer of collateral from one distinct entity to another. This scenario triggers a different analysis from that called for in name change cases, but, as Mr. Burke observes, the *Kittyhawk* court seems to have treated the case as a name change because the shareholders and officers of the transferor and transferee were the same. Burke, *supra* note 2, at 1088; *see infra* note 175 (analysis appropriate to collateral transfer cases). *But see* Hastings Note, *supra* note 2, at 974-75 (wherein it is urged that *Kittyhawk* should be treated as an "identity transfer" which should be treated as name changes, as distinguished from "third-party transfers").

157. The business of imputing knowledge of a debtor's conduct after filing is considered *infra* note 170 and accompanying text.

change in advance of filing, whereas Citizen learned of the name change after filing. This distinction, according to the court, placed *Kalamazoo* in the category of an *ab initio* case,[158] comparable to other instances where the secured party files a financing statement that fails properly to identify the debtor in the first place.

The dissent in *Continental*, however, raised persuasive arguments in favor of extending the good faith exception to cases where the secured party learns of a debtor name change after filing.[159] According to the dissent, a secured party with actual knowledge of the post-filing change is unjustifiably awarded an enforceable secret lien, unjustifiably because little or no burden would result were the secured party with actual knowledge of the change required to refile.[160] Be that as it may, there are few cases extending the good faith exception to instances in which the secured party learns of the change after filing.[161]

What remains of the good faith exception after section 9-402(7)? It is arguable that the exception is implicity overruled upon the adoption of the provision, which is cast in seemingly absolute terms. The secured party has no duty to refile to remain perfected in collateral acquired up to four months after the debtor's name is changed, and the secured party's knowledge of the change

158. Continental Oil Co. v. Citizens Trust and Sav. Bank, 397 Mich. 203, 208, 244 N.W.2d. 243, 244 (1976).

> We agree with the Court of Appeals' decision and adopt completely the analysis which distinguishes between those situations involving names of debtors appearing on the financing statement which are misleading *ab initio* and those involving a subsequent name change which differs from the name appearing on the original financing statement.

Id. The analysis to which the Michigan Supreme Court refers is that in which the court of appeals characterized *In re* Kalamazoo Steel Process (Burnett v. H.O.V. Corp.), 503 F.2d 1218 (6th Cir. 1974), as in the nature of an *ab initio* case. *Continental Oil Co.*, 397 Mich. 203, 244 N.W.2d 243.

159. 397 Mich. at 210, 244 N.W.2d at 245 (Williams, J., dissenting).

160. *Id.*

161. *In re* White, 51 Bankr. 514 (E.D. Tenn. 1985) is such a case. There the secured party filed under the name of its partnership debtor. The partnership thereafter dissolved, a fact of which the secured party was acutely aware as a party to the dissolution, but the business was continued as a sole proprietorship under the original trade name by one of the former partners. The Bankruptcy Court expressly rejected the secured party's attempt to distinguish *In re* Kalamazoo Steel Process (Burnett v. H.O.V. Corp.), 503 F.2d 1218 (6th Cir.1974), on the basis that in *Kalamazoo Steel* the secured party knew of the anticipated changes of name at the time the financing statement was prepared and filed.

It is curious that the court in *White* also relies on *In re* West Coast Computer Servs., 91 Bankr. 170 (M.D. Fla. 1982) which, although holding that a secured party is obliged by section 1-203 to refile to reflect a transfer of collateral that occurred after filing, expressly reserved "[t]he question of whether a secured party has a corresponding duty when a contemplated transfer to a successor debtor is not set forth in the security agreement . . . ." *White*, 51 Bankr. at 172.

at any time prior to the expiration of the grace period is apparently immaterial. At the same time, the secured party's obligation to refile to continue the perfected status of the security interest in after acquired collateral (collateral acquired outside four months from the date of the name change) is likewise absolute: the secured party must refile, and lack of notice or knowledge of the change does not abrogate the obligation.

The lack of reference to knowledge in section 9-402(7), however, does not conclusively rule the good faith exception out of existence. To the extent that the secured party's failure to act on actual knowledge of a name change amounts to commercial bad faith, the exception theoretically survives the adoption of section 9-402(7). The real problem, however, does not lie in preserving the exception, but in deciding the circumstances under which it can be applied consistently with the goals and policies of section 9-402(7). To this end, it becomes necessary to consider, once again, the occasions on which the exception has arisen.

Kalamazoo, it will be recalled, held that a secured party with advance knowledge that the debtor's name will be changed after filing acts in bad faith in failing to file a new financing statement, at least after the change occurs. It is, perhaps, unfortunate in some respects that the refiling exception was tied to the Code's good faith provision at all. As defined in Article 1, good faith means honesty in fact, a subjective standard by which the parties to a transaction within the ambit of the Code are to conduct themselves.[162] There is, frankly, little in *Kalamazoo* to suggest that the secured party's honesty in fact, or lack of it, is at the root of the court's decision, but there is much to suggest that the holding in the case is the product of detached balancing not unlike that which accounts for the different results in the *ab initio* and misindexing cases.[163] A secured party who files knowing at the time the financing statement will shortly be rendered misleading looks very much like the secured creditor who fails to identify the debtor properly in the original financing statement.[164] Such a creditor is, perhaps, even less deserving of our sympathy, but, more important, this creditor is in a position to ensure at no cost that the anticipated change will not render the financing statement misleading. The obligation to refile or take other corrective action does not bring with it a policing duty, such[165] that its imposition is arguably justified even if there are none but hypothetical searchers to be misled.

162. *See supra* note 151.

163. *See supra* notes 149-54 and accompanying text (discussing the case and the exception); *see also infra* note 176.

164. Similar reasoning is employed by the Michigan Supreme Court. *See supra* note 155 and accompanying text (discussing Continental Oil Co. v. Citizens Trust and Sav. Bank, 397 Mich. 203, 244 N.W.2d 243 (1976)).

165. This is a fact of some importance. The distinction is between the duty to refile, involving only the trivial cost of refiling, and the duty to discover that a debtor's post-filing conduct has rendered the financing statement seriously misleading.

Tying the holding in *Kalamazoo* to good faith forces attention upon the secured party's honesty and away from the simple balancing that reveals the exception as applied in *Kalamazoo* to be a close relative of the *ab initio* cases. It also invites criticism, as exemplified by the *Continental Oil dissent*,[166] where a court refuses to extend the exception to require refiling when the secured party acquires actual knowledge of the name change after filing.[167] It is, in point of fact, difficult to entertain the notion that the secured party in the latter case is somehow more "honest" than the secured party in the former.[168] It is more satisfying to view the majority opinion in *Continental* as a refusal to impose a monitoring obligation upon a secured party to discover if a debtor's post-filing conduct has rendered the financing statement misleading, in much the same way as the drafters of the Article refused to hold the secured party accountable for the fate of the financing statement at the hands of the filing officer. This is to say only that the secured party is no more obliged to police the debtor than to police the filing officer, for all the same reasons.

Putting aside the matter of good faith or secured party honesty in distinguishing *Kalamazoo* from *Continental*, a new problem surfaces. It is one thing to say that a secured party without prior knowledge that a debtor intends a name change is not obliged to monitor the debtor's post-filing behavior to discover conduct that renders the filing misleading. This scenario is very like the misindexing cases. It is something else again to say that the secured party who does acquire knowledge of the change should not act on

166. Continental Oil Co. v. Citizens Trust and Sav. Bank, 397 Mich. 203, 210, 244 N.W.2d 243, 245 (1976) (Williams, J., dissenting); *see supra* text accompanying note 159.

167. *Continental Oil Co.*, 397 Mich. at 210, 244 N.W.2d at 245 (Williams, J., dissenting).

168. Commentators have pointed out the illogic of this position, see, for example, Hastings Note, *supra* note 2, at 971-72 (discussing the dissent in *Continental Oil*), while the few cases requiring a refiling to reflect a debtor name change or transfer of collateral after the original financing statement is filed reject the distinction, although the basis upon which they do so is not absolutely clear. *See, e.g. In re* White, 51 Bankr. 514, 517 (E.D. Tenn 1985). The majority of cases considering the question, however, have regarded the time a secured party learns of misleading debtor conduct as controlling. *See, e.g., In re* Kittyhawk Television Corp. (Corwin v. R.C.A. Corp.), 516 F.2d 24 (6th Cir. 1975); *In re* Hammons (Fedders Fin. Corp. v. Borg-Warner Acceptance Corp.), 438 F. Supp. 1143 (S.D. Miss. 1977); *In re* Gac, 11 U.C.C. Rep. Serv. (Callaghan) 412 (Bankr. W.D. Mich. 1972); *see also* Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982) (a secured party is not obligated to refile under section 9-402(7) to continue perfected in collateral transferred notwithstanding knowledge of the transfer); American City Bank v. Western Auto Supply Co., 631 S.W.2d 410 (Tenn. Ct. App. 1981). *But see In re* Veiths, Inc., 9 U.C.C. Rep. Serv. (Callaghan) 943 (E.D. Wis 1971) (invalidating a security interest in inventory and accounts for the secured party's failure to prepare a new security agreement and refile on learning the debtor, formerly a sole proprietor, had incorporated and transferred the assets of the proprietorship to the new corporation).

it and refile. The difference is between imposing an obligation to discover or know and imposing a duty to act on actual knowledge that somehow comes to the secured party. Whether or not there are real searchers to be misled, the secured party with actual knowledge of a name change is in a position to correct the misleading financing statement without effort or cost. The secured party in these circumstances closely resembles the secured party in the *ab initio* cases.

As to the secured party who acquires knowledge of a debtor name change after filing, the scenario is not unlike the misindexing cases to the extent both arise out of post-filing conduct. This suggests the two cases should receive similar treatment, no duty to refile in either case. On the other hand, it is difficult to understand why the duty to refile should not be imposed in cases where the secured party has actual knowledge of the change so long as the refiling duty is not accompanied by a duty to monitor and discover the change. This amounts to little more than an extension of the basic principles at the root of the *ab initio* and misindexing cases.[169]

It is conceivable that a duty to act on post-filing knowledge could, practically speaking, result in a duty to discover, hence, a duty to police. The problem becomes one of deciding under what conditions to charge a secured party with such knowledge.[170] When can it be said that representatives of the secured party whose active involvement in the transaction has ended are reawakened to the transaction? Under simple agency principles it would be an easy matter to charge the secured party with knowledge of a debtor name change upon the receipt by clerks of remittances bearing a new debtor name.[171] This would offer no assurance, however, that those who could appreciate and act on such knowledge had actually acquired it. The end result would be a duty to discover — to police — not merely to refile.[172]

Meaningful acquisition of actual knowledge by those with the sophistication to recognize its significance might be determined ad hoc, but this would necessarily introduce the uncertainties that attend fact-laden soft tests

169. That is, the secured party with knowledge arguably incurs no greater expense in refiling than the secured party in the *ab initio* cases who is obliged only to prepare an accurate financing statement in the first place.

170. For Professor Kripke this is a very large practical problem indeed. *See supra* note 108.

171. See *id.*

172. One author has argued that one case, *In re* A-1 Imperial Moving & Storage Co., 350 F. Supp. 1188 (S.D. Fla. 1972), implicitly imposes an absolute duty to discover in the process of imposing an obligation to refile upon a debtor's post-filing name change that was unknown to the secured party. *See* Hastings Note, *supra* note 2, at 970.

Mr. Burke analyzes the same case as a transfer of collateral problem. In fact, the case did involve an individual debtor who granted a security interest in equipment, incorporated and, apparently, transferred the collateral to the corporation. *See generally* Burke, *supra* note 2, at 1090.

generally,[173] thereby increasing the risk that knowledge will be attributed to secured parties to whom it was never meaningfully conveyed. In short, an ad hoc determination might well increase the risk that a refiling obligation would become a monitoring obligation. This is not to say that an obligation to discover, or the costs of that obligation, is never justified. Indeed, it is a simple fact of secured financing after section 9-402(7) with its absolute duty to refile as to post grace period collateral. Nevertheless, the section 9-402(7) refiling requirement is limited to after acquired collateral which is more likely to be the subject of second-time financing. Second-time credit is less likely to be extended on the strength of stagnant collateral such as equipment, and monitoring costs difficult to justify. To take the calculus a step further, as the likelihood that real searchers exist diminishes, the costs of monitoring — even the risk that such costs might be imposed — are more and more difficult to justify.

Transfer of Collateral Under Section 9-402(7)

The matter of collateral transferred by the debtor to another creates a related but different set of problems from those arising where the debtor's name is changed after filing. The transferee's rights vis a vis the collateral, the secured party, and the debtor are relatively clear. Where a third party enters the stage to transact with the debtor's transferee, the question of the misleading financing statement surfaces once more. Should the third party take the form of a potential secured party who wishes to create a security interest in the transferred collateral, a search under the transferee's name will not, of course, disclose the prior interest. Nevertheless, the earlier perfected security interest, undiscoverable though it may be, will prevail.[174] This is the pronouncement of the third sentence of section 9-402(7) the Transfer clause.

The unsuspecting creditor of the transferee, like the second-in-line creditor who extends credit to the debtor after a name change, evokes a sympathetic response on equitable grounds. Once again, though, it must be asked whether the would be victim of the transfer exists outside hypothesis. That is, are there reliance creditors who extend credit on the strength of transferred collateral? As in the name change cases, the answer may depend upon the nature of the collateral.

173. This point is, in some respects, at the heart of the entire matter of debtor name change and transfer. The principles of clarity, certainty, and simplicity are antithetical to the introduction of fact-laden, ad hoc analysis to determine such things as whether a secured party knew or should have known of some post-filing activity undertaken by the debtor or whether a potential secured creditor was misled by an inaccessible financing statement or failed to perform a sufficiently diligent search. It seems that such inquiries, which may cost a great deal in terms of simplicity and certainty, are simply not justified, absent some powerful reason to do so, some terrible inequity.

174. *See generally supra* note 18 and accompanying text.

The problems confronting the creditor of the transferee are different in many respects from those facing the creditor of the debtor with a new name.[175] The circumstances of the first secured party are likewise different in the case of transferred collateral. If obliged to refile to remain perfected in transferred collateral, the task of the prior secured party would be one of policing the movement of the collateral, presumably a costly and tedious task indeed.[176] The business of checking the secretary of state's office every four months in name change cases seems trivial beside the procedures that would be required to monitor the movement of, for instance, inventory.[177] At the same time, if the prior secured party is freed from any such obligation, the creditor of the transferee must trace the title of the collateral,[178] and the fact of transfer

175. Mr. Burke asserts: "Where the debtor transfers the collateral to a different legal entity, substantially different policy and Code considerations are brought into play and different questions must be asked." Burke, *supra* note 2, at 1088 (footnote omitted). The different questions and considerations, Mr. Burke goes on to say, involve section 9-306(2) of the Code which provides: "[A] security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless . . . authorized by the secured party in the security agreement or otherwise . . . ." An authorized disposition, as Mr. Burke observes, extinguishes the security interest, mooting the question of whether refiling to continue perfection is required. *Id.* at 1088-89. At least two courts have adopted this clear-cut approach to the question of collateral transfers, asking first whether the security interest survived the transfer at all, and only then raising the question of refiling to continue perfection. *See, e.g., In re* Southern Properties (Richmond Fixture and Equip. Co. v. Hyman), 44 Bankr. 838 (E.D. Va. 1984); Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982).

176. Intuitively, it seems reasonable to suppose that where commercial lending is high volume and on a large scale, the costs to monitor the collateral could be prohibitive. On the other hand, I must confess that I am unaware of any systematic, exhaustive study of monitoring costs, so that the only generalization I might safely make is that policing the collateral is probably most often more costly than the cost of checking public records for name changes and the cost to refile a financing statement if such a change is discovered.

Nevertheless, the idea that the costs of following the collateral could be so high as to seriously affect the usefulness of secured lending is widely accepted. From the perspective of the economist, it is a matter of eroding the savings differential permitted by secured lending in the first place. *See generally supra* notes 93-94 and accompanying text. From what I have characterized as the episodic approach, it is simply unrealistic to expect the meaningful continuing contact between enlightened representatives of secured lenders and the debtor that would be necessary to maintain to detect a transfer of the collateral. *See generally supra* note 108.

177. *See generally supra* note 136 and accompanying text (concerning the floating lien in inventory).

178. Professor Kripke, speaking to this duty, provides the following explanation, or justification, for imposing a title tracing obligation on the searcher, rather than a policing obligation on the filer:

> The decisive point in determining whether change of ownership should call for a refiling is that there is no system of recording changes of ownership of personal property in the United States (in contrast to the system of

will not, of course, be revealed by a visit to the secretary of state's office.

Under the Code, the matter of continuing *perfection* in transferred collateral is unresolved.[179] Little is to be learned from cases involving transfers which draw no distinction between transfer and name change cases.[180] In section

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> recording deeds for real property), except in special situations like those of airplanes and motor vehicles. Therefore, anyone dealing with a purported owner of property, whether the transaction is an acquisition or a loan, must either rely on the apparent owner's warranties of title or must find means to trace the ownership of the property. In the course of tracing, he should discover the prior ownership and should be able to search the names of prior owners for security interests. Thus, there is little reason for imposing burdens of awareness of transfers, with the attendant problem of defining knowledge, on existing secured parties and their lay or paraprofessional assistants.

Kripke, *supra* note 107, at 74 (footnote omitted).

Professor Westbrook, on the other hand, states:

> The official comment [to section 9-402(7)] explicitly states that in order to be protected from the transfer provision, the secured lender to the transferee must check "the debtor's [transferee's] source of title." After a century or more of legal endeavor to develop a workable system of security interests in personal property, after the creation of the "most modernized, most comprehensive" security statute in the world, the secured creditor is reduced to reviewing bills of sale. Of course, much can be said for a certificate-of-title system for personal property, but our society has not chosen to accept the enormous cost and complication of such a system. Absent such a system, reliance on bills of sale is ludicrous. Aside from the cumbersome procedures required (can one imagine auditing the bills of sale for all of Chrysler's equipment?), no system ensures that such documents are reliable. The forging of a bill of sale is among the easiest possible frauds.

Westbrook, *supra* note 2, at 415 (footnotes omitted).

Mr. Burke acknowledges that the personal property title search may involve "a tedious review of reams of paperwork applicable to several tiers of ownership," but observes that "[s]ection 9-402(7) does not add to this . . . burden but merely confirms that it is the responsibility of the search creditor." Burke, *supra* note 2, at 1100. In the end, it may be that clear confirmation of search and refiling duties is a matter of greater practical importance than deciding to whom such duties should belong.

179. Section 9-306(2) under the 1962 version provides for the continuation of the interest upon unauthorized disposition, (U.C.C. § 9-306(2) (1962)), but nothing in the 1962 Code directly addresses the question of the effect of disposition upon the perfection of that interest. Since pre-Amendment courts didn't draw a distinction between transfer and name changes anyway, the lack of direction on the question of continuing perfection after transfer was inconsequential.

180. Hastings Note, *supra* note 2, at 966. Mr. Burke observes, "many of the . . . transfer of collateral cases seem to proceed upon the unstated premise that when collateral is transferred to a corporation that continues to be owned and operated by the same persons who controlled the transferor, the corporate identity may be disregarded and the case may be treated as though no transfer had occurred and only a name change is involved." Burke, *supra* note 2, at 1092; *see, e.g., In re* Kittyhawk Television Corp. (Corwin v. R.C.A. Corp.), 516 F.2d 24 (6th Cir. 1975); *In re* Westcoast Food Sales (Towers v. Holmes Sales Co.), 637 F.2d 707 (9th Cir.

9-402(7), however, the drafters addressed the question directly and resolved it in favor of the first filer; that is to say, there is no duty to refile against transferred collateral.[181] This means it is encumbant upon the creditor of the transferee to trace his debtor's source of title by whatever methods available.[182]

After-Acquired Property and the Debtor's Transferee

The distribution of burdens according to section 9-402(7) in the transfer cases is unremarkable in light of, among other things, the Name Change clause. No refiling is required to remain perfected in collateral acquired up to four months from a debtor's name change, and no refiling is required to remain perfected in collateral transferred. As for collateral acquired outside the four month period following a change in name, the secured party must refile. Is there any such thing as after acquired collateral in transfer cases? Certainly, the transferor/debtor could continue to acquire collateral captured by an after-acquired property clause.[183]

What of personalty acquired by the transferee from elsewhere than the transferor debtor? Is the secured creditor of the transferor debtor perfected as to personalty acquired by the transferee from other sources? Strictly speaking, this is a technical impossibility. To put it more robustly, it is a question that cannot, in theory, be asked absent a security agreement between the prior secured party and the transferee.[184] Nevertheless, in a number of cases

1981). There is reason to believe that courts will draw such a distinction under section 9-402(7). *See, e.g.*, Çitizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982) (refusing to treat the incorporation of a sole proprietorship as a name change). What is arguably a more serious problem arising out of the characterization of the debtor's conduct as either a transfer or identity change under section 9-402(7) is considered at text following *infra* note 203.

181. U.C.C. § 9-402(7). *See generally supra* note 175 and accompanying text.

182. *See supra* note 178. This tracing versus policing business is an old dilemma with a long history.

183. *See infra* note 184 and accompanying text (discussing after-acquired collateral). *But see infra* note 187.

184. See Burke, *supra* note 2, at 1094:

> [I]t should be emphasized that the section [9-402(7)] is instructive only in determining whether a new filing is required . . . in order to continue the perfected status of a security interest. The section assumes the existence of a security interest to perfect; and other sections . . . [i.e. section 9-306(2)] must be consulted to determine whether a security interest in collateral . . . has been extinguished by an authorized disposition.

Id. (footnotes omitted). In light of this view of the matter, Mr. Burke later reveals that he is disappointed with the case *In re* Taylorville Eisner Agency (Houchen v. First Nat'l Bank), 445 F. Supp. 665 (S.D. Ill. 1977), in which it was held that the after-acquired inventory of the debtor's transferee was "cdllateral" within the definition of that word as used in the third sentence of section 9-402(7). *See also In re* the question has not only been asked, but, it has been answered affirmatively, under both the '62 Code and the '72 Amendments.[185]

If such a result seems bizarre, it appears less so in light of two sources of confusion involving section 9-402(7). The first, and least difficult of the two to resolve, has to do with after-acquired collateral, in particular, inventory and accounts receivable. The second results from the failure of section 9-402(7) to offer guidance in distinguishing name changes from collateral transfers.

Inventory exists to be sold.[186] Since inventory as collateral subject to a security interest is spontaneously regenerated,[187] it is as much a category as it is a term used to describe individual items that fall within it. So long as the debtor continues to restock, inventory as a source of collateral is never exhausted, notwithstanding that inventory may consist of entirely different items from one month, one quarter, one time period to the next. The classification inventory, one might say, is greater than the items which constitute the classification. With this in mind, a few courts have regarded the transfer of items of inventory as somehow tantamount to a transfer of the category, such that items later acquired by the transferee independent of the transferor

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West Coast Food Sales (Tower v. Holmes Sales Co.), 637 F.2d 707 (9th Cir. 1981) (where proprietorship debtor incorporated and transferred its existing accounts receivable to the corporation, prior security interest in accounts receivable extended to receivables of the transferee/corporation after the transfer). *But see* Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982) (citing with approval Mr. Burke's analysis in cases of incorporation and transfer, the court refused to recognize a security interest in the after acquired collateral of the corporation/transferee).

185. *See, e.g.*, *supra* note 184 (cases cited therein).

186. U.C.C. § 9-109(4). *See generally supra* note 130 and accompanying text (discussing the development of the law in inventory financing).

187. Inter Mountain Ass'n of Credit Men v. Villager, Inc., 527 P.2d 664, 669 (Utah 1974) (footnote omitted);

> Inventory subject to a security interest should be looked upon as a single entity and not as a collection of individual items. The res, which is the subject of the lien, is the merchandise or stock in trade, conceived of as a unit, presently and continuously in existence—a floating mass, the component elements of which may be constantly changing without affecting the identity of the res.

Id.; *see also* Borg-Warner Acceptance Corp. v. Wolfe City Nat'l Bank, 544 S.W.2d 947, 951 (Tex. Ct. App. 1976) ("We Believe that the phrase 'all inventory' was sufficient to give other creditors notice in not only the inventory possesssed by the debtor at the time of execution of the security agreement but also inventory acquired thereafter until the debt was paid.")

There is probably nothing in the above statements antithetical to Mr. Burke's analytical approach to collateral transfers; on the other hand, it is one thing to say that inventory is a category of collateral, something more than the sum of individual items on hand at any one time (see generally *supra* note 130 and accompanying text), but it is something else again to conclude that the category can be transferred (*see, e.g.*, *In re* Taylorville Eisner Agency (Houchen v. First Nat'l Bank), 445 F. Supp. 665 (S.D. Ill. 1977)), since this is tantamount to the creation of a security interest with the transferee as debtor without a security agreement. *See infra* note 196 and accompanying text; *see also infra* note 188.

debtor have been held to fall within the inventory clause of the original security agreement.[188] This point might be cleared up by a modification of the transfer clause of section 9-402(7) to make it absolutely clear that a secured party remains perfected in collateral actually transferred by the debtor. The security interest would continue to be perfected, for instance, in the items actually transferred out of the debtor's inventory. In the event these items are also held for sale by the transferee (are inventory), this fact alone should not entitle the secured party to a security interest, perfected or otherwise, in items of inventory acquired by the transferee from other sources than the transferor-debtor.

Transfers and the Alter-ego Transferee

A more complex aspect of the problem has to do with the language from the Name Change clause of section 9-402(7) concerning activity of entity-debtors that renders a financing statement seriously misleading. That is, where the debtor is an "organization," refiling is required upon the debtor's name change, change in identity or corporate structure. It is not always an easy matter, however, to decide whether the activity of an entity debtor should be regarded as a change of identity or corporate structure on the one hand, or a transfer of collateral on the other.[189] For instance, a sole proprietorship[190] or partnership may incorporate.[191] A corporate debtor might

188. *See supra* note 187; *see also* Burke, *supra* note 2, at 1090-92 (discussing cases). Fliegel v. Associates Capital Co., 272 Or. 434, 537 P.2d 1144 (1975), tacitly avoids the creation problem by reliance on a successors and assigns clause in the security agreement. This argument is criticized by Burke, *supra* note 2, at 1091. *See also supra* note 184.

189. *See* Burke, *supra* note 2, at 1088 & n.17, 1095 & n.41; *see also* Hastings Note, *supra* note 2, at 979, 983 (treating debtor incorporation and transfers of assets to the corporate entity as an identity change or change in corporate structure).

190. *See, e.g.*, Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982). For a discussion of sole proprietorship incorporation cases decided under the '62 Code, see Hastings Note, *supra* note 2, at 967-68.

An interesting twist on the sole proprietorship theme is seen in *In re* White, 51 Bankr. 514 (E.D. Tenn. 1985). There, the debtor partnership dissolved to become a sole proprietorship which continued to operate under the partnership name, the name listed on a financing statement perfecting a security interest that had been granted by the partnership. Under these facts, it was held that the dissolution was an identity change that could seriously mislead searchers and that, upon learning of the change, the secured party was compelled, under the 1962 Code, to refile under the sole proprietor's name.

191. *See, e.g.*, *In re* Taylorville Eisner Agency (Houchen v. First Nat'l Bank), 445 F. Supp. 665 (S.D. Ill. 1977); *In re* Sofa Centres, Inc. (Avdoyan v. Sun Bank), 18 U.C.C. Rep. Serv. (Callaghan) 536 (Bankr. M.D. Fla. 1975); Borg-Warner Acceptance Corp. v. Bank of Marin, 36 Cal. App. 3d 286, 111 Cal. Rptr. 361 (1973); Fliegel v. Associates Capital Co., 272 Or. 434, 537 P.2d 1144 (1975). These cases are criticized in Burke, *supra* note 2, at 1090-92, 1100-01.

dissolve and reincorporate or otherwise reorganize, or a debtor corporation might merge with another.[192] These organizational changes might well be attended by a transfer of the collateral,[193] complicating the business of deciding which clause of section 9-402(7) is to be consulted to determine the impact of the change upon perfection.

One solution is to look closely at the debtor and other organization involved in an effort to decide whether there has occurred a bona fide third-party transfer of collateral.[194] For example, where individual debtors incorporate then transfer business assets to the newly formed corporation whose shareholders, officers and directors consist entirely of the former individual debtors,[195] it certainly is arguable that an identity change, not a transfer, has occurred. The problem with this solution is in deciding when the debtor and transferee are sufficiently alike. In the partnership-to-corporation scenario, for instance, or in the individuals-to-entity case hypothesized, it is easy to conclude a mere identity change has taken place, but how much difference must there be between two entities before the movement of collateral from one to the next amounts to a genuine transfer of collateral?[196] Given the

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192. *See, e.g.*, Inter Mountain Ass'n of Credit Men v. Villager, Inc., 527 P.2d 664 (Utah 1974).

193. *See, e.g.*, Hastings Note, *supra* note 2, at 975 n.87 (cases collected therein).

194. *Id.* at 974-75. Some cases have taken this approach, asserting that a debtor cannot be permitted to destroy a security interest by a change in structure or identity. *See, e.g.*, *In re* West Coast Food Sales (Towers v. Holmes Sales Co.), 637 F.2d 707 (9th Cir. 1981) (a security interest in the accounts receivable of a proprietorship debtor continues in the accounts receivable of a corporation that succeeded to the assets and liabilities of the proprietorship); Fliegel v. Associates Capital Co. 272 Or. 434, 537 P.2d 1144 (1975); *Inter Mountain Ass'n*, 572 P.2d 664. Other courts have rejected this alter-ego approach. *See, e.g.*, Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982).

195. *In re* Taylorville Eisner Agency (Houchen v. First Nat'l Bank), 445 F. Supp. 665 (S.D. Ill. 1977), regarded incorporation and transfer to be governed by the third sentence of section 9-402(7) (i.e., a transfer case), but held that the inventory acquired by the new corporation subsequent to the transfer of assets was subject to the security interest granted by the individual debtors.

196. *In re* Kittyhawk Television Corp. (Corwin v. R.C.A. Corp.), 516 F.2d 24 (6th Cir. 1975), treated a transfer of assets from one corporation to another corporation with identical officers, directors, and shareholders as a name change. The court regarded the transferee as the alter-ego of the transferor. Mr. Burke criticizes this approach, observing that:

> This "alter ego" approach to the refiling problem may decide the easy cases where the transferor and the transferee are indistinguishable; and it will usually produce equitable results, at least in those instances in which the competing interest being asserted does not press reliance considerations. However, it is a weak foundation upon which to build a refiling doctrine since it offers no neutral principles upon which one can determine when a transfer will be honored and when it will be disregarded. If the competing claimant in the *Kittyhawk* case had been a secured creditor of the transferee

possible variations on the reorganization theme, to establish a test to measure identity would be a difficult task indeed, and, assuming satisfactory guidelines could be arrived at, there would remain the ad hoc business of applying them from case to case.

The fact is, any solution to the transfer-versus-identity change problem that focuses on the nature and composition of the debtor and transferee necessarily introduces some ad hoc consideration and, therefore, the likelihood of inconsistent results from one case to the next. Besides, this approach in effect leaves it to the debtor and transferee to decide the matter of which clause of section 9-402(7) applies.[197] As the prior secured party and creditor of the transferee may be profoundly effected by the application of one clause or the other,[198] it makes more sense to view the transfer from without, as it appears to be. That is, the inquiry should begin with the manifestations, the trail of the debtor-transferee conduct left in available public records. Thus, without regard to similarities between the debtor and transferee, without regard to the considerations which motivated them to accomplish the transfer in one way or another, the decisive factor in determining whether an identity change or a transfer has occurred would be how the activity is reflected publicly. To be specific, where, for instance, a partnership incorporates and transfers the collateral to the new entity, the fact of incorporation will be recorded publicly and, therefore, be discoverable as a corporate name change. When the debtor's conduct is discoverable by recourse to such public records as disclose customary entity name changes, the debtor's conduct should be so regarded for section 9-402(7) purposes. In a sense, this converts the secured party's name change monitoring duty to one of guardianship of a category

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> who had been misled by the absence of a filing in the name of the transferee, the court might have found it more difficult to disregard the transfer, although it could have reached the same result applying the transfer rules articulated above. Or, if the transferee in the *Kittyhawk* case had acquired new equipment and the secured creditor of the transferor had claimed secured status as to the new equipment by virtue of an after-acquired property clause, the court would undoubtedly have recognized the separate legal status of the transferee. If transfers are disregarded because of the management or ownership similarities of the transferor and the transferee, it will never be possible to determine how much change in ownership, control or business activity will result in recognition of the separate legal status of the transferee for purposes of creating and perfecting a security interest in the assets of the transferee. It is apparent that alter ego as a refiling theory is incompatible with the purpose of the filing rules of article 9 since it will not produce uniform filing or search rules that can be safely relied upon in structuring secured transactions.

Burke, *supra* note 2, at 1092.

197. This would seem to be a matter of some concern to those courts that have refused to require a refiling based on the maxim that a debtor cannot be permitted to destroy the security interest. *See supra* note 60.

198. *See supra* note 178 and *infra* note 205 and accompanying text.

of public records, those records wherein name changes are recorded. If to do so broadens the secured party's responsibilities in terms of the kinds of acts of the debtor that may result in a refiling duty — in the sense that some debtor activity that involves a transfer could not strictly be characterized as a name change, the monitoring obligation itself would still be confined to those records the secured party is obliged to police every four months anyway.

It is true, of course, that the arguable cases involving activity which shares name change and transfer features, the close calls, could just as well be presumed transfers. This would mean that searchers would be required to discover the prior interest in all such cases through a title search. If it is the case that there are few reliance searchers anyway, it makes some sense to resolve the question this way. On the other hand, however few real searchers there may be, it is difficult to justify relieving a secured party of an obligation to refile when the evidence of the debtor's activity is contained in the very records the secured party must search every four months. What is more, if compelled to refile in these circumstances, the secured party is relieved of any anxiety generated in trying to decide whether his debtor's conduct amounts to a name change or a transfer. If the secured party harbors real doubt in the matter, the possibility of creating a security agreement with the "transferee" should be considered.[199]

If the reader will allow that classifying post-filing conduct by recourse to public records outside the filing system is provocative in some respects, it must be conceded that to incorporate the concept into Article 9 might well be more complex than the problem warrants. Absent uniform statutory schemes across jurisdictions governing the matter of recording entity activity, reference to such laws in an Article 9 provision would have to be extremely broad and general, giving rise to vagueness and uncertainty. With this in mind, it would be less problematic to suggest this resolution of the name change and transfer problems in a general way in a comment to section 9-402(7). The notion that the decision might be made according to the independent recording statute in a jurisdiction would be instructive only, the relative usefulness of any particular state's law in resolving the question a matter left to the courts in that jurisdiction.

It seems that some language, either in section 9-402(7) or in a comment to that section, should at least acknowledge that a decision must be made that a debtor's conduct is either a name change or transfer, and offer some direction in arriving at the decision. For example, section 9-402(7) might be modified to provide that a name change has occurred, even if accompanied by a transfer, where the debtor and entity against whom the secured party would enforce

199. That is to say, the secured party should enter into a separate security agreement in which the transferee grants a security interest and perfect the newly created security interest without regard for the prior security interest granted by the transferor.

its security interest are substantially similar. This, of course, would merely raise the question rather than resolve it, and deciding substantial similarity would once again fall to the courts which would be compelled to fashion an ad hoc test. On the other hand, it may be that to bring the issue to the attention of the parties by expressly recognizing it would be to ensure that the matter is given consideration,[200] and even an inconclusive test such as substantial similarity would offer some guidance to secured parties uncertain about the nature and impact of their debtor's post-filing activity.

The Good Faith Exception and Collateral Transfers

Is there a place in the transfer cases for a good faith exception? That is, if the secured party knows of the transfer, does section 1-103 compel refiling? There is really no good reason not to impose a *refiling*[201] duty upon a secured party who acutally knows collateral has been transferred, whenever that knowledge is acquired. As in the name change cases, the problem is one of deciding when and under what circumstances to charge the secured party with actual knowledge that a transfer has occurred, or will occur. In other words, it is once again a question of a refiling duty as opposed to a duty to discover the debtor's post-filing conduct.[202] If there is no more reason to insulate the secured party with actual knowledge of a transfer than there is to insulate the secured party with actual knowledge of a debtor name change, there is no more compelling reason to charge a secured party with knowledge of a transfer of collateral.[203]

Name Change or Collateral Transfer:
Practical Effects Under §9-402(7)

However interesting it may be to discuss the problems associated with identifying name change and transfer cases in an effort to apply the appropriate clause of section 9-402(7), are there any practical efforts in drawing the distinction? That is, does it make any difference as a practical matter that a debtor's conduct is misconceived?

If the collateral is acquired prior to the debtor conduct that renders a financing statement misleading, under section 9-402(7) it is probably of no consequence to the second-in-line creditor how that conduct is classified. If the collateral was transferred, the security interest continues and continues per-

200. *See supra* note 120.
201. *But see supra* note 165 and accompanying text. *See also supra* note 178.
202. *See supra* text accompanying note 159 (discussing dissent in Continental Oil Co. v. Citizens Trust & Sav. Bank, 397 Mich. 203, 244 N.W.2d 243 (1976)); *see also supra* note 201.
203. *See generally supra* note 108.

fected without refiling. If the debtor's behavior is a name change, the secured party likewise has no duty to refile to remain perfected. The results in either case are symmetrical as to this class of collateral, and the true nature of the debtor's behavior largely irrelevant.

What about collateral that is after-acquired? Here, the characterization of the debtor's conduct as transfer or name change makes a difference only as to such collateral acquired within the four month grace period. If the debtor's conduct is determined to be a transfer, there is no section 9-402(7) question raised regarding collateral independently acquired by the debtor's transferee.[204] If, on the other hand, the debtor's conduct is regarded as a name change, the secured party is perfected in all collateral acquired by the debtor for four months after the change without refiling. The second-in-line creditor dealing with the debtor with reference to such collateral risks subordination to the undiscovered security interest. As to collateral acquired outside the grace period, the prior security interest is unperfected since there is a refiling obligation upon the secured party at that point. Simply put, in the case of a name change, the second-in-line creditor has a four month vigil over public records in which debtor name changes are recorded, and the prior secured party takes up that vigil after four months.

Thus, the searcher who either deals with a debtor with a new name or transferee cannot prevail against a prior secured party in a dispute over extant collateral under section 9-402(7). The searcher will prevail against the secured party in a dispute over after-acquired collateral, except that in the case of a name change the searcher will be vulnerable if he lends against this grace period collateral.

It is of greater theoretical importance to the prior secured party how a debtor's conduct is regarded under section 9-402(7). If the secured party chooses to regard his debtor's conduct as a change of name and simply refiles before the end of the grace period, a later determination that the debtor's behavior was, in fact, a transfer will mean the secured party has no security interest in collateral thereafter acquired.[205] If the secured party mistakes his debtor's name change for a transfer, presumably the creditor will seek a new security agreement from the transferee,[206] in which event it appears that no harm is done the secured party in the mischaracterizing.

Proposals: Should Section 9-402(7) Be Amended?

Is section 9-402(7) a glitch that must be corrected at the first opportunity?[207] So far as the absence of a duty to refile to remain perfected in pre-grace

204. *See supra* note 184 and accompanying text; *see also infra* note 205.
205. *See supra* note 175 and accompanying text.
206. *See generally supra* note 184 and accompanying text.
207. *See* Westbrook, *supra* note 2. Professor Westbrook describes section 9-402(7) as a "loophole in Article 9" that "seems inconsistent with the entire statutory scheme." *Id.* at 416-17.

period and grace period collateral is concerned, the answer is no, at least until it is demonstrated that those involved in drafting the provision were errant in their supposition that second-in-line lenders against such collateral exist only —or mainly — in hypotheticals.[208] This is not to say that the supposition is above challenge,[209] but that the Name Change and Transfer clauses of section 9-402(7) are consistent with that supposition. If it can be demonstrated empirically that lending against extant collateral figures largely into secured credit financing, it will be time enough to state a new rule.

What of the good faith exception? It is impossible to argue against a refiling duty where a secured party knows in advance the debtor's name will be changed or the collateral transferred after filing. It is only a little less difficult to argue against a refiling rule where a secured party learns that some post-filing debtor behavior has rendered a properly prepared, functional (to give public notice) financing statement seriously misleading. Unfortunately, to require refiling may be to require discovery of the post-filing conduct that necessitates refiling.[210] This presupposes that the absolute negotiability of pre-grace period and grace period collateral is a goal of sufficient importance that the monitoring necessary to achieve it is warranted.[211]

On an intuitive level, however, it is distressing to think that a secured party might learn of a misleading name change immediately or soon after it occurs and simply do nothing for up to four months while enjoying a secret lien in all collateral that the debtor acquires during that period.[212] The good faith exception might have some ameliorating use here in avoiding abuses of the four month rule.[213] On the other hand, according to the Sixth Circuit, at least, which appears first to have recognized the exception, it would not apply to these circumstances.[214] In any event, this is probably a matter best left to the courts to consider as such cases present themselves for review.

With regard to the good faith exception and collateral transfers, the exception can only apply to the collateral actually transferred, at least where

208. *See supra* notes 124-25 and accompanying text.

209. *See generally supra* note 7.

210. *See generally supra* note 170 and accompanying text.

211. It is a question of the price to be paid to assure that personalty subject to a security interest is freely alienable. The price to assure alienability in the event of a debtor name change or transfer of collateral is the forfeiture of the prior secured party's ownership rights. For a fascinating discussion of the negotiability of goods and the good faith purchase idea, see Gilmore, *The Good Faith Purchase Idea and The Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605 (1981). Therein, Professor Gilmore considers the possibility that the good faith purchaser idea was given a more important and influential place in the Code than it deserves. *See also* Note, *U.C.C. Section 2-403: A Reform in Need of Reform*, 20 WM. & MARY L. REV. 513 (1979).

212. *See generally supra* note 71 and accompanying text.

213. *See id.*

214. *See supra* note 155 and accompanying text.

a genuine transfer has occurred.[215] Unless it is shown that lenders against transferred collateral exist in sufficient numbers to warrant it, it would seem inappropriate to impose a discovery duty indirectly by recognizing a good faith exception.[216] Strictly speaking, as to after-acquired collateral of the debtor's transferee the good faith exception is irrelevant.[217] If any change in section 9-402(7) is warranted, it is the need for clarification, either in the text of the provision or in the comments thereto, of the alter-ego or identity-transfer question.[218] Unless and until some direction arrives, the effects from a lack of it can be minimized by the secured party who treats every kind of post-filing activity discovered in the course of the four month name change vigil as a threat to continued perfection.

Conclusion

Much of what is not self-evident about section 9-402(7) and the reasons it resolves the debtor name change and collateral transfer problems in the way it does may be explained, in part, by reference to practical suppositions and, to some extent, the received historical perspective of those influential in drafting the provision. If the provision suffers any weakness, it is that the drafters' suppositions about the practical realities of secured lending upon which the Name Change and Transfer clauses seem to be based are not directly available. It might be helpful if some such information were included in the comments. Among other things, to have a clear understanding of the drafters' perceptions might give new direction to scholarly criticism of provisions which seem to fail when analyzed in a vacuum.

215. *See generally supra* note 184 and accompanying text.

216. *See generally supra* notes 149-218 and accompanying text (discussing the good faith exception).

217. *See supra* note 215.

218. *See generally supra* note 196.