

STUDENT NOTE: POST-PETITION PERFECTION LAPSE UNDER U.C.C. § 9-515

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I. INTRODUCTION

11 U.S.C. § 362 provides for an automatic stay pertaining to certain actions taken after the filing of a bankruptcy petition.¹ However, § 362(b) does not operate as an automatic stay for others, including “any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee’s rights and powers are subject to such perfection under [11 U.S.C. § 546(b)].”² Section 546 subjects the powers of a trustee to “any generally applicable law” that either “permits perfection of an interest” or “provides for the maintenance or

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¹ 11 U.S.C. § 362(a) reads:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of [title 11] . . . operates as a stay, applicable to all entities, of—

- (1) the commencement . . . of a judicial, administrative, or other action or proceeding against the debtor . . . ;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under [title 11];
- (3) any act to obtain possession of property of the estate . . . ;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under [title 11];
- (6) any act to collect, assess, or recover a claim against the debtor . . . ;
- (7) the setoff of any debt owing to the debtor . . . against any claim against the debtor; and
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under [title 11].

11 U.S.C. § 362(a) (2010).

² 11 U.S.C. § 362(b) (2010).

continuation of an interest” in property.³ Of the laws mentioned in § 546, Uniform Commercial Code (the “U.C.C.”) § 9-515 details the effect of filing financing and continuation statements.⁴ Under U.C.C. § 9-515, a financing statement lapses five years after the date of filing, causing the once-perfected interest to become unperfected unless the secured party files a continuation statement.⁵

From these statutory provisions, several questions arise with regard to a secured party’s rights. First, does the filing of a continuation statement violate the automatic stay imposed post-petition under § 362? Second, what happens if a security interest becomes unperfected post-petition? Third and finally, because § 362 does not grant a stay to the filing of a continuation statement, does one evaluate the perfection status on the date of the petition or continuously throughout the proceeding? In other words, must a secured party file continuation statements during a bankruptcy proceeding to remain perfected with regard to that proceeding, in order to maintain one’s right of priority? These questions are explored in depth in the following sections.

II. FUNCTIONALITY OF THE CONTINUATION STATEMENT

As mentioned above, a party’s interest becomes unperfected upon the lapse of the financing statement, which occurs five years after the filing of the original financing statement.⁶ Once the interest becomes unperfected, a creditor becomes subject to potential reduction in priority against a conflicting interest in property.⁷ Thus, a secured party clearly wants to take action to maintain the perfection or to perfect its security interest. A secured party may maintain perfection of the interest by filing a continuation statement within the six months prior to the lapse of

³ 11 U.S.C. § 546(b)(1)(A)-(B) (2006). “The term ‘generally applicable law’ relates to those provisions of applicable law that apply both in bankruptcy cases and outside of bankruptcy cases.” S. REP. NO. 95-989, at 86 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787; *see In re Roser*, 613 F.3d 1240, 1242-43 (10th Cir. 2010) (including Colorado’s Uniform Commercial Code, which mimics the Uniform Commercial Code, within the term “generally applicable law”).

⁴ *See generally* U.C.C. § 9-515 (2010).

⁵ U.C.C. § 9-515(a), (c) (2010).

⁶ U.C.C. § 9-515(a) (2010). However, in the instance of a manufactured-home transaction or a public-finance transaction, the effective period for filing is thirty years. U.C.C. § 9-515(b) (2010).

⁷ “[P]riority among conflicting security interests . . . in the same collateral is determined according to” several rules. For example, a “perfected security interest . . . has priority over a conflicting unperfected security interest.” U.C.C. § 9-322(a)(1)-(2) (2010).

POST-PETITION PERFECTION LAPSE UNDER U.C.C. § 9-515

perfection.⁸ Once the party files an effective continuation statement, perfection of the security interest is maintained for five additional years following the date that perfection would otherwise lapse.⁹

However, the filing of a continuation statement serves no part in the perfection process, but rather the filing acts to maintain the perfection of the interest.¹⁰ The U.C.C. specifically mentions that parties must file continuation statements every five years to maintain perfection.¹¹ In the event of failure to file a security interest at the end of *any* five-year period, the effectiveness of the financing statement lapses and the security interest becomes unperfected.¹²

This concept was explained in *In re Concrete Structures, Inc.*, where a creditor sought to enforce a statutory lien by arguing that its actions were part of the perfection process.¹³ The court rejected this argument, utilizing the comment to the 1994 amendment to § 546(b) by stating that “certain actions taken during bankruptcy proceedings pursuant to the Uniform Commercial Code to maintain a secured creditor’s position . . .

⁸ U.C.C. § 9-515(d) (2010). If a party incorrectly files the continuation statement outside of the six-month period then that continuation statement is ineffective. U.C.C. § 9-510(c) (2001).

⁹ U.C.C. § 9-515(e) (2010).

¹⁰ 140 CONG. REC. H10752 (1994). The Legislative History of the 1994 amendment of §§ 362 and 546 describes their functionality:

Section 204. Continued perfection

This section sets forth an amendment to sections 362 and 546 of the Bankruptcy Code to confirm that certain actions taken during bankruptcy proceedings pursuant to the Uniform Commercial Code to maintain a secured creditor's position as it was at the commencement of the case do not violate the automatic stay. Such actions could include the filing of a continuation statement and the filing of a financing statement. The steps taken by a secured creditor to ensure continued *perfection merely maintain the status quo and do not improve the position of the secured creditor.*

Id. (emphasis added).

¹¹ U.C.C. § 9-515(a), (c) (2010).

¹² *Id.*

¹³ *In re Concrete Structures, Inc.*, 261 B.R. 627, 638 (E.D. Va. 2001).

merely maintain the status quo and do not improve the position of the secured creditor.”¹⁴

Applying this case and the statutes to the present dilemma, the filing of a continuation statement falls within the “maintain perfection” portion of §§ 362 and 546. While the statute does use the word “may” with regard to the filing of a continuation statement and subsequent continuation statement filings, one *must* file the continuation statement every five years in order to maintain perfection.¹⁵ Furthermore, if one fails to file a continuation statement properly, the financing statement “is deemed to never have been perfected as against a purchaser of the collateral for value.”¹⁶ It is important to note, however, that erasing the perfection from history only applies to purchasers for value, including a bankruptcy trustee under 11 U.S.C. § 544(a), not judicial liens or other forms of acquisition.¹⁷

III. FILING A CONTINUATION STATEMENT DOES NOT VIOLATE THE AUTOMATIC STAY

A short, but important point is that filing a continuation statement does not violate the automatic stay. In fact, the legislative history of §§ 362 and 546 specifically state that financing statements and continuation statements fall short of violating the automatic stay imposed by § 362.¹⁸

Unlike the filing of continuation and financing statements, taking an action described in § 362(a) may violate the automatic stay.¹⁹ In the event of an automatic stay violation, subsection (k) provides that an individual injured by “any willful violation” of a stay may recover actual damages, including costs, attorneys’ fees, and, in some instances, punitive damages.²⁰ However, one should note that damages incurred as a result of a stay violation are markedly different from damages incurred by

¹⁴ *Id.* (quoting *supra* note 10).

¹⁵ U.C.C. § 9-515(d)-(e) (2010).

¹⁶ U.C.C. § 9-515(c) (2010).

¹⁷ *Id.*; see *In re Miller Bros. Lumber Co.*, No. 1:12CV720, 2013 U.S. Dist. LEXIS 152176, at *1, *16 (M.D.N.C. Oct. 23, 2013) (quoting *In re Highland Constr. Mgmt. Servs.*, 497 B.R. 829, 837 (Bankr. E.D. Va. 2013)).

¹⁸ 140 CONG. REC. H10752 (1994).

¹⁹ 11 U.S.C. § 362(a).

²⁰ 11 U.S.C. § 362(k).

seeking relief from such violation, and the latter form of damages may be considered unattainable.²¹

IV. EFFECTIVE DATE TO DETERMINE SECURED-PARTY RIGHTS

Every state has adopted the pertinent part of U.C.C. Article 9,²² and courts addressing post-petition lapse have carved out a clear majority²³ on the issue of whether to evaluate perfected status on the petition date or continuously throughout the bankruptcy proceeding.²⁴ The majority view holds that the effective date of perfected-status determination is the petition date. Within that majority, some courts have only limited their opinions in support of the majority approach to individuals, not against purchasers for value. Thus, they have not weighed in on the latter issue. These opinions involve a number of statutory interpretation techniques, and both sides present valid arguments about whether a petition-date analysis or continuous analysis

²¹ See *In re Hutchings*, 348 B.R. 847 (Bankr. N.D. Ala. 2006) (holding that actual damages are restricted to an individual injured by any willful violation of a stay, and that in this particular case lost wages and travel expenses incurred due to prosecuting violation of automatic stay were not actual damages).

²² Each state's statutory provisions regarding secured transactions in the commercial code required subsequent filing of continuation statements to maintain perfection. However, one state does not maintain the thirty-year provision of the U.C.C., and others limit some other portions of § 9-515. Nonetheless, in one form or another, every state has adopted the portions of Article 9 discussed in this note.

²³ I use the term "majority" to describe that basically all jurisdictions addressing the issue under the new statutory scheme have ultimately ruled in favor of this view. However, there may be some jurisdictions where courts held in favor of the "minority" view under the old scheme. For example, Tennessee held that, under the old scheme, post-petition lapse would negate a once-perfected interest. See *In re Chattanooga Choo-Choo Co.*, 98 B.R. 792 (Bankr. E.D. Tenn. 1989). Eventually, Tennessee sided with the majority under the new scheme. See *In re Stetson & Assocs.*, 330 B.R. 613 (E.D. Tenn. 2005). Absent that subsequent decision, Tennessee courts may have found the decision under the old scheme persuasive. Additionally, the *Highland* and *Miller Brothers* cases, discussed later, originally held with the "minority" view in a prior opinion. Upon rehearing, both decided that the "majority" was more persuasive. Thus, there is certainly an argument that reasonable minds could still differ on the issue – considering that they have historically – despite the present-day uniformity on post-petition lapse.

²⁴ While U.C.C. Article 9 construction is based upon state law, district courts "have original and exclusive jurisdiction of all cases under title 11." 28 U.S.C. § 1334(a) (2005).

of perfected status should govern. Two cases, highlighting the majority approach, were decided just two years ago, and only a few months apart.

A predominant majority-opinion case is *In re Miller Brothers Lumber Company* (“*Miller Brothers*”).²⁵ In this case, one party argued for a security interest on the petition date, but almost two months later that interest’s financing statement lapsed due to failure to file a continuation statement.²⁶ Originally, the United States District Court for the Middle District of North Carolina upheld the minority view, determining that a security interest becomes unsecured upon its lapse post-petition.²⁷ The court originally held this view because of a prior provision, which tolled the lapse upon the filing of a bankruptcy or insolvency proceeding.²⁸ Thus, most likely because the new statutory provision did not include direct language in its revised form, the first court held that the financing statement expired post-petition.²⁹

However, a year later, the court revisited the issue and overruled its prior decision.³⁰ In its subsequent opinion, the district court believed that because the last sentence in the subsection³¹ —dealing with purchasers for value—no longer contained the term “lien creditor,” it did not intend for a lien creditor to “never have been perfected” upon lapse of a financing statement.³² The court also held that “[t]rustees in bankruptcy [were] included within the definition of ‘lien creditor.’”³³ Thus, because the security interest had not “never existed” on the petition date, the secured party retained priority. Additionally, the court declined to “determine the applicable time during which the creditors

²⁵ *In re Miller Bros. Lumber Co.*, No. 1:12CV720, 2013 U.S. Dist. LEXIS 152176, at *1, *2 (M.D.N.C. Oct. 23, 2013).

²⁶ *Id.* at *3.

²⁷ *In re Miller Bros. Lumber Co.*, No. B-11-51405, 2012 Bankr. LEXIS 2031, at *1, *5 (M.D.N.C. May 8, 2012).

²⁸ *Id.* at *7-8.

²⁹ *Id.* at *9-10.

³⁰ *Miller Bros. Lumber Co.*, 2013 U.S. Dist. LEXIS 152176, at *23.

³¹ The last sentence reads: “If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.” U.C.C. § 9-515(c) (2010).

³² *Miller Bros. Lumber Co.*, 2013 U.S. Dist. LEXIS 152176, at *16.

³³ *Id.*

POST-PETITION PERFECTION LAPSE UNDER U.C.C. § 9-515

rights are determined.”³⁴ The court also did not determine the function of a post-petition lapse as against a purchaser for value.³⁵

In a more in-depth analysis of the majority approach, the *In re Highland Construction Management Services* (“*Highland*”) court held that a “secured party whose financing statement lapses loses his position to all parties with perfected security interests” except for lien creditors obtaining a judicial lien prior to the financial statement’s lapse.³⁶ Justice Mayer began his opinion with the ironic statement: “When is a financing statement that is no longer effective, still effective? When it lapses, of course!”³⁷ As such, *Highland* bears similarity to *Miller Brothers* in that both state statutes formerly contained language that provided tolling on the petition date and the inclusion of lien creditors with purchasers for value with regard to the “deemed never to have been perfected” provision.³⁸ As in *Miller Brothers*, the statutes in *Highland* changed to adopt the U.C.C. provisions that eliminated the lien holder and tolling provisions.³⁹ Finally, and possibly most interestingly, *Highland* was also decided upon a rehearing from a prior case.⁴⁰ In fact, the earlier *Highland* opinion found the first *Miller Brothers* case persuasive in its analysis.⁴¹

First, *Highland* addressed the textual interpretation of the statute, holding that the language described, what Justice Mayer opined as a “commonsense answer,” that a “financing statement ceases to be effective” upon lapse – unperfected any once-perfected security interest and subsequently losing priority against competing perfected security interests.⁴² On the other hand, Justice Mayer looked to comment 3 of the statute, which described how the law “deemed” retroactive unperfection

³⁴ *Id.* at *8-9.

³⁵ *Id.*

³⁶ *In re Highland Constr. Mgmt. Servs.*, 497 B.R. 829, 838 (E.D. Va. 2013).

³⁷ *Id.* at 831.

³⁸ See VA. CODE ANN. § 8.9A-515(c); N.C. GEN. STAT. § 25-9-515(c).

³⁹ *Highland Constr. Mgmt. Servs.*, 497 B.R. at 837.

⁴⁰ See *In re Highland Constr. Mgmt. Servs.*, No. 11-11413-RGM, 2013 Bankr., LEXIS 1264 (E.D. Va. Mar. 29, 2013).

⁴¹ *Id.* at *9.

⁴² *Highland Constr. Mgmt. Servs.*, 497 B.R. at 835.

against purchasers for value.⁴³ The court found that, because “deemed” is a “fictional substitute for actual retroactive perfection,” there was no actual retroactive unperfection.⁴⁴ Thus, “[t]he reality is that the security interest of the secured party whose financing statement lapsed remains perfected.”⁴⁵

Justice Mayer found the circumstances surrounding such lapse irrelevant as a practical matter.⁴⁶ Indeed, considering that the function of a financing statement is to give notice through the filing office, once the financing statement expires “it may, literally, not give any notice to anyone” because such filing office is only required to maintain the record for a year after lapse.⁴⁷ The court also discussed the various merits of the two approaches before deciding that, ultimately, the “deemed to never have existed” sentence would “have no meaning” if the court determined that a lapsed statement remained effective.⁴⁸ However, the security interest remained perfected because the secured party faced a lien instead of a purchaser for value.⁴⁹ *Highland* criticized the original *Miller Brothers* opinion for not taking certain aspects of its analysis into consideration and eventually opined that had *Miller Brothers* considered the *Highland* method of statutory interpretation the original *Miller Brothers* decision would have arrived at a different result.⁵⁰ As it turns out, a few

⁴³ *Id.* at 835-36.

⁴⁴ *Id.* at 836.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.* It is important to note, however, that the statutory provision states only that the “filing office shall maintain” records of financing statements for at least one year after expiration and provides no requirement of destruction. *See generally* U.C.C. § 9-522 (2010). The issue of these cases is whether such perfection is maintained with regard to the specific proceeding and the interests competing for priority, under §§ 362 and 546, must be filed before the proceeding. Therefore, a counter-argument to Justice Mayer’s conclusion is that the parties would be notified of the security interest and its perfection status on the petition date because such information could be found in the pleadings or during discovery. Likewise, the filing office is required to maintain records for at least one year after expiration. Thus, the secured party would have at least one year to acquire proof of its perfection on the petition date.

⁴⁸ *Id.* at 843.

⁴⁹ *Id.*

⁵⁰ *Id.* at 842-43.

POST-PETITION PERFECTION LAPSE UNDER U.C.C. § 9-515

months later, *Miller Brothers* actually reconvened on the issue and attained a different result.⁵¹

Regarding the “freeze rule,” neither court determined dispositively whether it applied to post-petition perfection status. The freeze rule states: “[L]ien priorities are determined as of the filing of the petition in bankruptcy and are not altered during the pendency of the case.”⁵² Further, the freeze rule, as interpreted in *Lockhart v. Garden City Bank & Trust Co.*, would hold that “liens good at [the petition date] do not lose their validity as against the trustee.”⁵³ The *Miller* court addressed the “freeze rule” briefly, holding that “to the extent that the Bankruptcy Code determines rights” of the petition date “the provisions of [Article 9] . . . would be of no effect” if a debtor entered bankruptcy.⁵⁴ The *Highland* court also noted that the bankruptcy code was not dispositive on when one should interpret secured status, but noted that 11 U.S.C. § 502(b) provides only that, as of the filing of the petition, the court determines only the amount of the claim.⁵⁵

In re Wilkinson (“*Wilkinson*”), however, applied the freeze rule to a secured party’s transaction.⁵⁶ *Wilkinson* advised that, even under the freeze rule, parties should file the continuation statement during the proceeding regardless of tolling, because “a secured creditor who fails to file a post-petition continuation statement is protected within the bankruptcy proceeding *but accepts the risk that the debtor’s bankruptcy proceeding may fail*, thus leaving them to contend with competing parties under the [statute] in the aftermath of an unsuccessful bankruptcy proceeding.”⁵⁷

⁵¹ See *Miller Bros. Lumber Co.*, 2013 U.S. Dist. LEXIS 152176, at *1.

⁵² *Highland Constr. Mgmt. Servs.*, 497 B.R. at 838.

⁵³ *Id.* at 838-39 (citing *Lockhart v. Garden City Bank & Trust Co.*, 116 F.2d 658, 661 (2d Cir. 1940)).

⁵⁴ *Miller Bros. Lumber Co.*, 2013 U.S. Dist. LEXIS 152176, at *21-23.

⁵⁵ *Highland Constr. Mgmt. Servs.*, 497 B.R. at 839.

⁵⁶ *In re Wilkinson*, No. 10-62223, 2012 Bankr. LEXIS 1539, at *1, *5 (Bankr. N.D.N.Y. Apr. 10, 2012).

⁵⁷ *Id.* at *12-13 (emphasis added).

Nevertheless, it is important to note that becoming unperfected is not the same as becoming unsecured. The court in *In re Colony Beach & Tennis Club, Inc.* (“*Colony Beach*”) wrestled with the issue of post-petition lapse, citing both *Miller Brothers* and *Highland* in its determination.⁵⁸ Still, the *Colony Beach* court explained that the lapse in a financing statement did not extinguish a security interest, but instead “[became] vulnerable to later-perfected security interests and judicial liens, which [were] not going to arise as long as the automatic stay [was] in effect.”⁵⁹ Lapse of perfection simply means that it is a priorities issue, not a secured-status issue.⁶⁰

The *Wilkinson* court noticed that “the majority of courts that have considered the issue of post-petition lapsing . . . in the context of state statutes without a bankruptcy tolling provision . . . have held that a properly filed financing statement does not lapse on the expiration of the original statement.”⁶¹ Tennessee is among the majority of states in this regard.⁶² Through the cases readily available, it seems that a majority view clearly exists within the confines of current judicial law.

However, none of the readily available cases have directly ruled on the function of a failure to file a continuation statement as against a purchaser for value — although most discussed the concept in dictum.

⁵⁸ *In re Colony Beach & Tennis Club, Inc.*, 508 B.R. 468, 479-80 (Bankr. M.D. Fla. 2014).

⁵⁹ *Id.* at 480.

⁶⁰ The court described the four instances when a perfected secured claim on the petition date can become unsecured:

- (1) if the underlying claim is later invalidated, the lien securing it can be avoided by 11 U.S.C. § 506(d);
- (2) if the value of the collateral, as of the petition date, is determined to be less than the amount of the underlying claim, then the secured claim can be “stripped down” or completely “stripped off” by 11 U.S.C. § 506(a) and an unsecured claim for the deficiency;
- (3) if the lien impairs an exemption a secured claim may be “avoided” by an individual debtor, by 11 U.S.C. § 522(f); or
- (4) a lien may be “avoided” by a bankruptcy trustee (or a debtor-in-possession armed with a trustee’s powers), by the provisions of 11 U.S.C. § 544-549.

Id. at 479.

⁶¹ *Wilkinson*, 2012 Bankr. LEXIS 1539, at *11.

⁶² *See* *Great Am. Ins. Co. v. Merchs. & Planters Bank*, No. 2:05-CV-2519, 2008 U.S. Dist. LEXIS 23006, at *1, *33-34 (W.D. Tenn. Mar. 21, 2008) (explaining that, even though the financing statements lapsed during bankruptcy, the plaintiff maintained priority).

Even if we assume that secured status is determined on the date of the petition, the next layer in the determination is whether the *determination itself* is on the date of the petition. In other words, does one deem the evaluation occurring on the date of the petition or during the proceeding? It follows logically that if we deem a “freezing” effect on everything relating to the proceeding, the evaluation itself would remain frozen in time. Thus, the secured party would not have been “deemed never perfected,” if evaluated at the petition date as against a purchaser for value. Even with this fanciful string of logical assumptions, one can easily glean the opposite result from the case law discussed above. While none of the readily available cases rule directly on post-petition lapse against a purchaser for value, they all imply that, at least to some degree, a post-petition lapse loses perfection against such purchaser. In fact, *Miller Brothers* seems to permit post-petition lapse *because* of its allusion to post-petition lapse against purchasers for value.⁶³

What is more, Tennessee’s cases create a narrative similar to both *Highland* and *Miller Brothers*. *In re Chattanooga Choo-Choo Company* determined post-petition lapse ineffective, but held as such under the old statutory scheme.⁶⁴ In contrast, *Great American Insurance Company* determined that post-petition lapse would be effective, but its ruling was more concerned with a determination of priority as between secured and unsecured creditors, not among secured entities.⁶⁵ Finally, *In re Stetson & Associates, Inc.* held that post-petition lapses “[do] not change the priority scheme as between” the parties.⁶⁶ In Tennessee, it would appear that a majority – in fact a recent majority – agrees with the overall majority on post-petition lapse and would enforce such perfection despite post-petition lapse.

V. CONCLUSION

Despite some historical disagreement in the case law, a clear majority holds that a secured party maintains its perfection status within a bankruptcy proceeding regardless of post-petition lapse of the secured party’s perfected status. Nonetheless, one should avoid these problems

⁶³ See *Miller Bros. Lumber Co.*, 2013 U.S. Dist. LEXIS 152176, at *16-17.

⁶⁴ *Chattanooga Choo-Choo Co.*, 98 B.R. at 799.

⁶⁵ *Great Am. Ins. Co.*, 2008 U.S. Dist. LEXIS 23006, at *1.

⁶⁶ *In re Stetson & Assocs., Inc.*, 330 B.R. 613 (Bankr. E.D. Tenn. 2005).

by filing a continuation statement within the six-month period, or the last tenth of the entirety of the original perfection period, before the interest becomes unperfected.