

## Why Secured Lenders Must Mind The Gap In UCC Searches

By **Robert Wonneberger** (November 5, 2024, 3:20 PM EST)

Due to time delays between filing and indexing of Uniform Commercial Code financing statements, there can be valid perfected security interests that are not revealed in a UCC search.

If a lender does not take appropriate steps to address this possibility, its security interest may be subject to one or more unknown prior encumbrances. In a worst-case scenario, depending on the amount of those prior liens, the lender's collateral position could end up being worthless.

Obtaining a Uniform Commercial Code search is a useful tool to help determine if, and to what extent, a party's personal property is encumbered and the priority of a perfected security interest.

However, UCC-1 financing statements are not indexed immediately upon filing, and search results only include filings that have been indexed. As a result, properly filed financing statements will not show up in a search for some period of time.

Although the length of time varies, an anecdotal review of recent searches Barclay Damon attorneys received from third-party search companies showed that, across 10 jurisdictions, this gap ranged from one or two days to over two weeks.

A secured lender must take this gap into account when taking and dealing with collateral or risk being in a junior position.

### Loan Origination

At the loan origination stage, a lender typically obtains a UCC search prior to the closing to determine the status of the potential borrower's or guarantor's collateral and the priority of the security interest that will secure the new loan.

However, based on this indexing gap, there is a possibility of unknown security interests or liens being of record that are senior and prior in right to the lender's security interest yet unknown to the lender. Although this could create a huge problem, there is a way of avoiding the issue.

Often the financing statement for a new loan is filed at the time of closing. By signing the security



Robert Wonneberger

agreement, the borrower or guarantor automatically authorizes the filing of a financing statement.[1]

However, the UCC expressly allows a financing statement to be filed before the security agreement is executed as long as the party that will be granting the security interest provides signed written authorization to file.[2]

One method to obtain the needed authorization is to include it in the loan commitment letter, possibly coupled with an agreement to terminate the filing if the loan does not close.

Once all parties that will be granting security interests for the loan have signed and returned the commitment letter, the lender or its counsel can prepare and file the financing statements for the transaction.

Alternatively, although slightly later in the process, the lender or its counsel can obtain signed written authorization from the parties granting security interests at the outset of the loan document preparation stage and file the financing statements once the signed authorizations are received.

A lender might consider including the authorization in its loan application, but this method raises certain additional considerations.

First, many lenders do not use actual loan applications.

Also, a loan application may only be signed by the borrower, not by all parties, e.g., guarantors, that will be granting security interests.

Finally, a borrower may be reluctant to authorize the filing at this early stage, especially if it is speaking with more than one lender.

Once the lender's financing statements are filed, it need only ensure that the preclosing UCC searches are obtained long enough after the filing date to account for the indexing gap. If timed correctly, the lender's new financing statement will be included in the search, and the lender can be assured it is obtaining the priority it requires.

Other types of encumbrances — e.g., some judgment liens and tax liens — may be perfected by filing in a location other than the filing location of the lender's financing statement, and these filing locations will have their own indexing gaps.

To ensure the lender's priority, it must first determine which filing locations are relevant to the party granting collateral. Searches of those filing locations must then be timed so that their respective index dates are later than the filing date of the lender's financing statement.[3]

## **Enforcement**

The indexing gap is less of an issue at the enforcement stage.

In most circumstances, if the lender is disposing of collateral at a public or private sale, or accepting collateral in full or partial satisfaction of the obligation, it must provide written notice to, among others, parties holding a security interest in or other lien on the subject collateral that has been perfected by filing a financing statement.

In each situation, the UCC describes the specific time frame for the needed UCC search.

If the secured party is disposing of the collateral, notification must be sent to, among others, "any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that: ... (ii) was indexed under the debtor's name as of that date." [4]

The UCC also provides a safe harbor for determining the universe of secured parties or other lienholders that are required to receive notification of disposition.

A lender has complied with the notice requirements if "not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information identifying financing statements indexed under the debtor's name," i.e., a UCC search, and either does not receive a response to the request prior to the notification date or receives a response and sends notice to the secured parties and lienholders named therein. [5]

If the secured party is proposing to accept collateral in full or partial satisfaction of the obligation, it must send its proposal to, among others, "any other secured party or lienholder that, 10 days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that: ... (B) was indexed under the debtor's name as of that date." [6]

In both cases, the duty to provide notification is based on financing statements that are indexed — not just filed — as of the required date.

Accordingly, as long as the search is conducted at the proper time, it is irrelevant for notice purposes if there are additional filed financing statements that have not been indexed and, therefore, were not included in the search.

If not appropriately addressed, the UCC filing indexing gap can interfere with a lender's expected lien priority. However, taking appropriate preclosing actions and properly timing searches can eliminate this risk.

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[1] UCC 9-509(b).

[2] UCC 9-502(d), 9-509(a).

[3] This discussion addresses only security interests and liens that are perfected by filing. Further investigation would be needed to determine if there are existing encumbrances perfected by a different method.

[4] UCC 9-611(c)(3)(B).

[5] UCC 9-611(e).

[6] UCC 9-621(a)(2).