**Lapse, Continuation, and Termination of Security Interests**

Welcome to this podcast on Lapse, Continuation, and Termination of Security Interests brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is how a secured creditor goes about maintaining a perfected security interest in order to prevail against others who might claim the same collateral. This topic primarily requires a careful reading of UCC §§ 9-513 and 9-515 and a basic understanding of how a secured party attaches and perfects its security interest in the first place. The basic concepts associated with this podcast are: priority, perfection, lapse, termination, and continuation. Familiarity with these concepts will help you to understand what actions a secured creditor should and sometimes must take to maintain perfection of a security interest.

Recall that in order for a secured creditor to obtain *priority* with respect to collateral over other creditors it should *perfect* its security interest. While a secured party can perfect its security interest in a number of ways, including possession and control, most secured creditors will file a *financing statement* with the office of the relevant Secretary of State in order to perfect their security interest. A secured party will want to maintain its perfection and not allow it to lapse until there is no longer an obligation outstanding and no further obligations are contemplated.

If a secured creditor has a perfected security interest, what happens when the debt is paid? If a secured creditor has perfected its interest by possession, the secured creditor will simply return the collateral to the debtor. But what happens to a filed financing statement when the debt is paid? A secured party which perfected by filing must file with the relevant State Secretary of State’s office a form called a termination statement for the financing statement. After the secured party files a termination statement, the financing statement no longer operates to perfect a security interest. In essence, it terminates the effectiveness of the financing statement.

If the financing statement covers consumer goods, the secured party must file the termination statement if the debtor did not authorize the filing of the initial financing statement, or there is no obligation secured by the collateral indicated in the financing statement and no commitment to advance an obligation, or otherwise give value. Moreover, the secured party must file the termination statement within one month after there is no obligation or within twenty days after receiving an authenticated demand from the debtor. Failure to comply with a proper demand for a termination statement results in the secured party becoming liable for actual damages and a civil penalty of $500.

Let’s look at an example. My young son Marshall needed a clarinet for school, which I financed with the seller, Music City, granting them a security interest in the clarinet to secure payment of $50 per month for three years. Music City filed a financing statement. At the end of the three years or if I pay the debt early and no longer owe money to Music City, it must file a termination of the financing statement.

Let’s look at another example that poses problems for debtors and creditors. Terry Trouble filed a spurious financing statement with me listed as debtor and indicating that my dogs, Angus and Porter, are the collateral. If I did not authorize the filing of this financing statement, I can send a demand to Terry Trouble to file a termination statement and he will have to do so within twenty days after receipt of my demand. In the event that he does not file the termination statement, I can file an amendment to the financing statement and some states allow the debtor to file the termination or an affidavit of fraudulent UCC filing.

In the event that we have collateral that is not consumer goods, the secured creditor must still file a termination statement or provide one to the debtor within twenty days after receiving a demand in three situations. First, where there is no obligation outstanding. Second, where the financing statement covered goods subject to a consignment to the debtor but the goods are no longer in the debtor’s possession. Third, where the debtor did not authorize the filing of the initial financing statement.

Let’s look at some examples. Hypo #1. First Bank holds a security interest in my office equipment perfected by filing. Happily, I pay off the loan in full and request a termination statement. First Bank has twenty days to comply.

Hypo #2. Chris Carpenter makes custom sassafras furniture that he consigns to Owl’s Head Rustic. Getting good legal advice, Chris makes a financing statement filing covering the consignment. When the parties part ways and Owl’s Head Rustic no longer has any consigned goods, it can request a termination statement. Chris will have twenty days to comply.

Hypo #3. Terry Trouble files a spurious financing statement against all the furniture and inventory of Owl’s Head Rustic listing Second Bank as creditor. Because this financing statement is not authorized, Owl’s Head Rustic can make a demand to Second Bank to file a termination statement. Second Bank will have twenty days to comply.

Because the filing of a termination statement renders the initial financing statement ineffective, termination statements can only be filed when authorized. Moreover, parties should act with care in filing termination statements. In the case of *In re Motors Liquidation Co.*,concerning the General Motors bankruptcy, the court held as effective a termination statement erroneously filed prior to bankruptcy by the attorneys of General Motors. The court held that the secured party of record had authorized the filing. Authorization can occur regardless of whether the secured party had subjectively intended or understood the effect of the filing. Simply, General Motors had vested the attorneys with actual authority to file termination statements on their behalf such that a termination statement filed with respect to a $1.5 billion financing statement was effective, even though it was done erroneously.

It is important to note that financing statements do not last forever. They are only effective for five years. If a secured party wants to maintain their perfection for longer than five years, they would need to file a continuation statement. A continuation statement must be filed before the financing statement lapses. If the financing statement lapses prior to the filing of a continuation statement, it is too late -- the financing statement becomes ineffective and the secured party will have to begin the perfection process again with a new financing statement. In such a case, the secured creditor may find themselves being a junior creditor if there are other claimants to the same collateral who properly filed. A continuation statement, though, may only be filed within six months before the expiration of the five-year period.

Let’s look at an example. Diamond Dealers perfected a security interest in the diamond inventory of Elegant Jewelers by filing a financing statement on January 1, 2010. Diamond Dealers filed a continuation statement on August 1, 2014. Diamond Dealers filed another continuation statement, but neglecting its record-keeping, did not file the continuation statement until February 1, 2020. Diamond Dealers initially perfected its security interest by filing a financing statement and maintained its perfected status by filing the continuation statement in 2014, within the six-month window. However, Diamond Dealers became unperfected when it did not file a second continuation statement by January 1, 2020. Moreover, the late filed continuation statement is ineffective because there is no longer a financing statement to continue. If Brilliant Earth Diamonds had filed a financing statement listing the same collateral in 2018, it would now have priority because the financing statement of Diamond Dealers lapsed.

At this point, you should be able to describe the basic process of maintaining perfection of a security interest, including the requirements for filing a termination of a financing statement where required. You should also be able to describe why a secured creditor must make each of these filings.

I hope you’ve enjoyed this podcast on Lapse, Continuation, and Termination of Security Interests.

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