

## inside business

by Bradley E.  
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# *Security interests protect creditors*

**S**anta Barbara business owners often feel insulated from the economic ebbs and flows that impact California and the rest of the country as a whole.

However, considering the current economic climate, it never hurts for local businesses to prepare for the possibility that those around them may fall upon hard times.

Whenever extending credit, a business should consider taking security interests in the debtor's assets. Without security interests, creditors have little assurance that they will receive payment and recognize the value of the deal. Aside from creating an incentive to pay voluntarily, security interests offer collateral from which to secure payment. Without security, the creditor places its financial affairs into the debtor's hands.

Once a local business decides to take these protective measures, it may soon find itself thrust into a world governed by Division 9 of the California Commercial Code. Division 9 presides over the procedures for creating and enforcing security interests in most types of personal property in California. These procedures underwent significant changes as of July 1, 2001, with comparable provisions adopted in all states by April 1, 2002.

In large part, the revisions to Division 9 were aimed at simplifying the procedures for perfecting a security interest. Perfection serves a dual purpose. First, it alerts third parties of the existence of the creditor's security interest. Second, by placing the public on notice of the creditor's interest in the collateral, the creditor establishes its priority with respect to future creditors claiming an interest in the same collateral.

Although the procedure for perfecting a security interest depends upon the nature of the collateral, the most common procedure involves filing a document known as a "financing statement." The financing statement identifies the name and address of the debtor and creditor and describes the collateral securing the obligation.

Under the old law, the financing statement was typically filed with the secretary of state in the state where the debtor had its main office or where his or her assets were physically located, thereby creating a public record accessible by potential creditors advising them that the debtor has previously pledged the collateral. In theory, and in practice, this provision required the creditor to file several financing statements in different states. The revised Division 9 alleviates this problem by limiting the filing requirement to the state in which the debtor is located.

While revised Division 9 simplifies the perfection procedures by centralizing the filing requirements, creditors dealing with Santa Barbara companies can no longer rely on their local presence to determine where to file a financing statement. These creditors must now determine where these companies are located under the definitions of the new law and file in the appropriate state, which may not be California.

The transition between the old and new laws creates some pitfalls for the unwary creditor. Under the transition provisions, financing statements filed prior to the effective date of revised Division 9 (July 1, 2001) are effective until the earlier of: (1) their expiration date, (typically five years after filing); or (2) June 30, 2006.

Therefore, until June 30, 2006, potential creditors must continue to search the public records in all states in order to insure there are no competing priority interests in the collateral. Creditors who limit their search based on the new filing procedures may overlook competing security interests filed in other states.

A similar problem faces creditors who perfected their security interests under the prior law. Upon amendment or renewal, creditors who fail to follow the new procedures jeopardize the validity and priority of their security interest.

Although we live and work in a unique community, Santa Barbara business must not fail to recognize that we exist as part of a broader economy. In any credit transaction, businesses should protect themselves by acquiring an adequate security interest in the debtor's assets. In doing so, careful attention must be paid to adhere to the perfection procedures of revised Division 9.

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