BUSINESS BANKRUPTCY ALERT

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A GLOBAL LAW FIRM FOR THE 21st CENTURY

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UNIFORM COMMERCIAL CODE FILINGS IN TRADENAME ARE INSUFFICIENT AGAINST CHAPTER 11 DEBTORS

Under the "strong-arm" provisions of the bankruptcy code, a debtor or its trustee is given the status of a hypothetical lien creditor on the date of filing. 11 U.S.C. § 544. This means that creditors who have not properly perfected security interests in a debtor's property may have their lien avoided or made ineffective against the debtor or its property. In a Chapter 11 case, the debtor is vested with these avoidance powers and may exercise them for the benefit of its unsecured creditors. A debtor's knowledge of the secured creditor's intent or attempts to properly secure its interest is not relevant.

In order to maintain a security interest in property senior to the debtor as a hypothetical lien creditor, the creditor must possess a perfected security interest on the date the debtor files its bankruptcy petition. Generally speaking, this determination must be made under state law.

With certain exceptions, most interests in personal property are perfected by filing a financing statement with the secretary of state. The sufficiency of a financing statement and its effectiveness against avoidance actions in bankruptcy are governed by the Uniform Commercial Code and specific state laws that vary depending upon the collateral's location.

A recent case from the Bankruptcy Court for the Eastern District of Texas illustrates the importance of proper perfection of a security interest. *In re Stanton,* 2000 WL 1617981 (Oct. 20, 2000). In that case, the lender filed a financing statement under the debtors' tradename. The court held that the filing was ineffective as against the debtors in bankruptcy based upon their status as hypothetical lien creditors.

Under the Texas Uniform Commercial Code, a perfecting creditor is compelled to take particular care in identifying the debtor and avoiding the utilization of a tradename in lieu of the debtor's proper name. This ensures the accuracy and reliability of information provided to inquiring parties regarding the existence of security interests held by earlier creditors. Accordingly, in Texas the filing of a financing statement against a tradename is ineffective as a matter of law against a debtor in bankruptcy. Moreover, misspellings in the names of a debtor that are the result of a typographical error may also render a financing statement insufficient if the errors would be seriously misleading to a reasonably prudent subsequent creditor.

As a result of the secured creditor's attempts to file a financing statement against only the debtors' tradename in *In re Stanton,* the creditor was rendered unsecured by the bankruptcy court. Thus, the claims of the secured creditor were converted to unsecured claims for purposes of distribution under the debtors' plan of reorganization.

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