

## SECURITY INTERESTS IN BANKRUPTCY QUESTIONS

1. Big Bank (BB) made a \$100 unsecured loan to ABC Inc. (ABC) on Sept. 1, 2001. The loan documentation contained a so-called "springing lien" clause which allowed BB to demand collateral from ABC any time BB determined it was not satisfied with ABC's credit rating. ABC was downgraded by a credit rating agency and BB demanded collateral on Feb. 1, 2002. BB signed an appropriate security agreement on Feb. 15, 2002. BB properly filed an appropriate financing statement on Mar. 15, 2002. ABC filed for bankruptcy on May 30, 2002. Assume BB is not an insider of ABC.

- a. BB holds a perfected security interest in the collateral. ABC's bankruptcy trustee may not avoid the security interest because, although the trustee has the status of a hypothetical lien creditor as of the bankruptcy filing date, a lien creditor does not defeat a prior perfected security interest.
- b. If filing is an appropriate method of perfection for the collateral, BB holds a perfected security interest in the collateral. ABC's bankruptcy trustee may not avoid the security interest because its status as a hypothetical lien creditor on the date of the bankruptcy filing does not defeat a prior perfected security interest.
- c. If BB holds a perfected security interest in the collateral, ABC's bankruptcy trustee may not avoid it because the security interest was created more than 90 days prior to the filing of the bankruptcy petition.
- d. ABC's bankruptcy trustee may avoid BB's security interest because, on these facts, the transfer of the security interest is deemed to occur when the security interest was perfected.

2. Big Bank (BB) made an initially \$100 unsecured loan to ABC Inc. (ABC) on Sept. 1, 2001. BB signed an appropriate security agreement on Sept. 15, 2001 covering all equipment of ABC, now owned or hereafter acquired to secure the \$100 loan. BB properly filed an appropriate financing statement on Nov. 15, 2001. On April 15, 2002 ABC acquired 20 new machines used to assemble widgets. ABC filed for bankruptcy on May 30, 2002. Assume BB is not an insider of ABC.

- a. The attachment of the security interest in the new machines is a transfer of ABC's property in respect of antecedent debt within 90 days of bankruptcy and may be avoided by ABC's bankruptcy trustee.

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b. BB holds a perfected security interest in the new machines that may not be defeated by ABC's bankruptcy trustee because the security interest was created on Sept. 15 and perfected on Nov. 15, both more than 90 days prior to ABC's filing of a bankruptcy petition.

c. BB has a perfected security interest in both the 20 new machines and in any widgets produced by the machines as proceeds of collateral, neither of which may be avoided by ABC's bankruptcy trustee because the UCC filing was made prior to the applicable 90 day preference period.

d. BB holds a perfected security interest in the new machines because, even though ABC did not acquire rights in the new machines until April 15, perfection of the security interest in this collateral relates back to the filing of the financing statement on Nov. 15.

3. Big Bank (BB) made a \$100 secured loan to ABC Inc. (ABC) on Sept. 1, 2001 that was properly documented and perfected shortly after funding of the loan. On April 30, 2002 Local Bank loaned ABC \$100 and, on the same day, properly perfected a security interest in the same collateral. ABC filed for bankruptcy on May 30, 2002. The collateral is worth \$200 in a liquidation. ABC owed BB \$5 of accrued unpaid interest when it filed for bankruptcy. After the bankruptcy filing, an additional \$10 of interest accrued prior to the payment of creditors. Assume BB is not an insider of ABC.

a. BB will receive \$105 and Local Bank will receive \$95 from the collateral. Interest stops accruing when a bankruptcy petition is filed, both security interests are otherwise perfected and these security interests may not be avoided by the bankruptcy trustee.

b. BB will receive \$110 and Local Bank will receive \$0 from the collateral because Local Bank was perfected within the 90 day preference period.

c. BB will receive \$115 and Local Bank will receive \$0 from the collateral because Local Bank perfected its security interest within the 90 day preference period.

d. BB will receive \$115 and Local Bank will receive \$85 from the collateral. A secured creditor may receive post-petition interest paid from its collateral, both security interests are otherwise perfected and these security interests may not be avoided by the bankruptcy trustee.

4. XYZ Co. sold Debtor five machines on April 1, 2002 for \$1000. Debtor paid for

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the machines with \$200 cash and a \$800 note payable to XYZ Co. On April 1, 2002 Debtor signed an appropriate security agreement describing the five machines. On April 10, 2002 Debtor filed for bankruptcy. On April 15, 2002, Debtor filed a financing statement describing the five machines in the appropriate UCC filing office, naming Debtor, as debtor, and XYZ Co., as secured party.

- a. XYZ Co. does have a perfected security interest in the five machines. However, the bankruptcy trustee for Debtor may avoid this security interest because it was a transfer made on April 15 in respect of an antecedent debt incurred on April 1.
- b. XYZ's security interest is perfected because it is a purchase money security interest that enabled Debtor to acquire the five machines and was perfected in a timely manner.
- c. XYZ Co. does not have a perfected security interest in the five machines because a creditor may not take actions after the filing of a bankruptcy petition to perfect a security interest. XYZ Co. should have filed its financing statement immediately (or, indeed, prior to advancing funds).
- d. Attachment occurs at the time of perfection. Here, attachment occurred outside the statutory 10 day grace period so the interest is unperfected unless XYZ Co. can convince a court that the perfection of the security interest occurred substantially simultaneously with its creation.

5. XYZ Co. sold Debtor five machines on April 1, 2002 for \$1000. Debtor paid for the machines with \$200 cash and a \$800 note payable to XYZ Co. On April 1, 2002 Debtor signed an appropriate security agreement describing the five machines. On April 10, 2002 Debtor filed for bankruptcy. On May 5, 2002, Debtor filed a financing statement describing the five machines in the appropriate UCC filing office, naming Debtor, as debtor, and XYZ Co., as secured party.

- a. XYZ Co. violated the automatic stay by filing its financing statement. XYZ Co. is unperfected. The "perfection" of the security interest, however, is not a preference because it was made after the bankruptcy filing, not before the bankruptcy filing. As the security interest was unperfected at the time of the bankruptcy filing (and not timely perfected thereafter) the transfer of the security interest is deemed to have occurred on the date of bankruptcy.
- b. The filing of the financing statement perfected the security interest. The perfection of a security interest is the date on which you measure a transfer of

an interest of the Debtor in property. Unfortunately for XYZ Co., this transfer occurred in respect of antecedent debt and thus may be avoided as a preferential transfer.

c. XYZ's security interest is unperfected because the security interest is a post-petition asset. XYZ may not have a security interest in a post-petition asset of the Debtor unless the security interest is in proceeds of collateral in which XYZ had a perfected security interest prior to the bankruptcy filing.

d. XYZ Co. properly perfected its purchase money security interest so long as a court finds that the filing of the financing statement occurred substantially contemporaneously with the making of the loan and the creation of the security interest.

6. On Jan. 1, 2002, Big Bank (BB) obtains a perfected security interest in all of Debtor's inventory and equipment. BB's security agreement does not contain an after-acquired property clause. Between Jan.1 and June 1 debtor sells all its old inventory and buys new inventory. Debtor files for bankruptcy on June 1, 2002, having acquired no new equipment since Jan. 1. On August 1, 2002 Debtor sells all its equipment and then existing inventory for cash. On August 15, 2002 Debtor uses the cash received from sale to purchase new inventory and equipment. BB claims a security interest in the new inventory and equipment. The bankruptcy trustee for Debtor disagrees.

a. BB's security interest does not extend to the new assets acquired with proceeds of inventory because the absence of an after-acquired property clause in the security agreement prevented the security interest from attaching to inventory acquired by Debtor after Jan. 1.

b. BB's security interest does not extend to the new assets acquired with proceeds from the sale of the equipment because the security agreement does not contain an after-acquired property clause (which is needed for the equipment but not for the inventory).

c. BB's security interest does extend to the new assets acquired with proceeds from the sale because the new assets constitute proceeds of pre-petition collateral in which a security interest was perfected and the proceeds are traceable. On these facts, the after-acquired property clause is not even needed.

d. BB's security interest does not extend to the new inventory or equipment. A security interest may not attach to collateral acquired by the Debtor after the filing of a bankruptcy petition.