



Experts Corner: “Trustee Unable to Avoid Security Interest Perfected Post Petition”

Trustee Unable to Avoid Security Interest Perfected Post Petition

A bankruptcy trustee generally has broad power to avoid a security interest that is unperfected on the date the debtor files its bankruptcy petition. However, there are some very narrow exceptions. A recent Tenth Circuit case, *In re: Rosen*, 2010 U.S. App. LEXIS 14817 (10th Cir. July 20, 2010), offers an example of how perfection can be effective post-petition.

In *Rosen*, the debtor obtained a loan from Sovereign Bank (“the Bank”) on May 19, 2007, to purchase a motor vehicle. The debtor received possession of the vehicle that same day. Nineteen days later, on June 7, 2007, the Bank submitted the paperwork to perfect its purchase-money security interest in compliance with the Colorado Certificate of Title Act (“CCTA”).

However, on May 31, 2007, before the bank filed its paperwork under the CCTA, the debtor filed a Chapter 7 bankruptcy petition. The bankruptcy trustee sought to avoid the security interest because the Bank was unperfected on the petition filing date. The trustee also claimed that the Bank’s post-petition perfection violated the automatic stay.

The Bank argued that it was entitled to perfect its security interest post-petition under Section 546(b) of the Bankruptcy Code. Section 546(b) provides that the trustee’s avoidance powers are subject to any generally applicable law that permits perfection of a security interest to be effective against an entity that acquires rights in the collateral before the date of perfection.

UCC Section 9-317(e) provides that if the secured party files its financing statement to perfect a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest relates back to the time of attachment. The Bank claimed that UCC Section 9-317(e) was a generally applicable law that gave it rights in the collateral pre-petition. Under UCC Section 9-311(b), compliance with the CCTA was the equivalent of filing a financing statement. Therefore, perfection of the lien post-petition was permitted by Section 546(b) and the trustee could not avoid the lien.

The bankruptcy court and Bankruptcy Appellate Panel for the Tenth Circuit found in favor of the trustee. Both courts relied on an earlier case, *In re O’Neill* (citation omitted), that held the trustee could avoid a security interest in a vehicle because the CCTA supersedes the Colorado UCC. The CCTA establishes priority when a purchase-money security interest filed under the CCTA conflicts with another lien filed under the CCTA. The courts both concluded that Section 9-317(e) did not apply to a security interest in a motor vehicle perfected under the CCTA.

The Tenth Circuit rejected the *O’Neill* case and reversed the lower courts. The circuit court reasoned that the CCTA established the date of perfection, but not priority. The CCTA did not govern priority relative to interests perfected under law other than the CCTA, such as judgment liens. Instead, UCC Section 9-317(e) governs priority in light of the CCTA perfection date. Because priority related back to the date of attachment, the Bank had priority over the rights of



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other creditors that arose after the debtor acquired the vehicle. Therefore, the Bank’s post-petition perfection did not violate the automatic stay, and Section 546(b) prevented the trustee from avoiding the security interest.

The important thing to take away from this case is that any delay in perfection carries risk. While there are a few situations where a security interest can be perfected after the debtor has filed for bankruptcy, the secured party will often be at risk if it fails to perfect promptly. In *Rosen*, the Bank had the benefit of UCC Section 9-317(e). However, that would not have been the case had the issue not involved a purchase-money security interest.

Whenever possible, the secured party should perfect its security interest before advancing funds or allowing the debtor to take possession of the collateral. Fortunately, UCC Section 9-502(d) permits the secured party to perfect any time, even before the security agreement is made or the security interest attaches. The secured party need only obtain the debtor’s authorization to effectively file before the closing.

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