

Commercial Finance Exam, Bernhardt  
Student #

Under the Strong Arm Clause, a trustee in bankruptcy can avoid a security interest that is unperfected at the time of the filing of the bankruptcy petition. The trustee generally releases collateral subject to any kind of lien or SI that is valid at the moment of filing of the bankruptcy petition.

The trustee is a hypothetical judicial lien creditor and therefore has priority over any unsecured claims. The creditors of MM should agree to a reorganization plan that at least gives them an amount equal to or more than they would receive from a liquidation of MM's assets. Distribution of MM's Assets could go as follows:

#### Inverness Lending (IL)

IL has a secured claim in all present and after-acquired inventory, but this claim may have lapsed. A financing statement (FS) is effective for five years from the date of filing. Unless a continuation statement is filed in the six months before expiration of the five year period, the security interest (SI) becomes unperfected. Therefore, the date of the filing of the FS will determine whether they have a priority interest in inventory.

We know that the FS was likely filed in 2001. If the five year period expired before the filing of the bankruptcy, then IL is unperfected and the trustee as a hypothetical lien creditor has a priority claim over the inventory. If the FS is actually expired, the inventory that is not secured as collateral by other creditors can be sold and the proceeds distributed to the unsecured creditors, including IL, equally.

Usually there is not much left for the unsecured creditors, and in MM's case we know there is at least one other unsecured creditor (Supplier B) that IL has to share the proceeds with. Since IL would not receive much through liquidation of the property under these circumstances, they would likely approve a plan where they were at least given something. Sharing the proceeds of the inventory with Supplier B should make IL happy.

However, if the SI in inventory did not yet expire and a continuation statement was filed, then IL has rights to the inventory, which would be the non-SSW screens that MM makes, 1,000 free standing SilverScreens it was preparing to install in its monitors and used computer parts. IL could also claim they have priority to any cash or accounts they could trace as proceeds of the collateral.

#### Acton Loans (AL)

AL has a security interest in all present and after-acquired notes, accounts and chattel paper held by MM since 2002 and can repossess this collateral if they get relief from the automatic stay. AL has priority to the conditional sales contracts and the cash in the special deposit accounts. Therefore the reorganization plan should use the large amounts

of conditional sales contracts and cash in accounts to pay the debt owed to AL. Any left over cash or contracts should be applied to paying other creditors. When AL takes over the contracts, they will have to notify the parties to the contract to make all future payments to them, instead of MM.

Silver Screen Works (SSW)

SSW has a secured interest in the Silver Screen Monitors they have sold to MM since 2003. Although these are "inventory" covered under IL's earlier FS, the screens are considered PMSI and have super priority since SSW sent proper notice before making shipments to MM, which indicates they have super priority as to the Silver Screen Monitors.

SSW would have a claim in the proceeds of their collateral as a matter of law. Therefore, the plan should give them all these screens because they will be entitled to any proceeds from the screens that they can trace.

Class A suppliers who have obtained judgments

Class A supplier have obtained judgments and levied execution on MM's assets are judicial lien creditors with priority over unsecured creditors. Class A Suppliers are therefore have priority over the Class B suppliers and Class A suppliers who only have judgments. A Suppliers who have levied will be paid from the proceeds of sale of items not covered by secured creditors, such as the Silver Screens and accounts. The remaining proceeds will be applied to the unsecured creditors.

Class B suppliers, who have not yet filed suit

The remaining property would be sold and proceeds would be distributed to the unsecured creditors. Usually there is not any money left to pay the unsecured creditors and they do not have a right to seek the deficiency from the discharged debtor. Therefore, the unsecured creditors will likely be favorable to this plan which puts them in at least the same position they would be in from a liquidation.

Class B suppliers will be in an especially good position if AL's security interest has expired because they will share in the proceeds of the inventory.

Certain banks holding mortgages on the real estate owned by some of MM's industrial customers (where the monitors were installed)

InDiv files its properly executed financing statements with the County recorder as fixture filing. A non purchase money security interest in fixtures loses to prior recorded interests in the realty, even if the fixture financier perfects by a fixture filing. However, the non-purchase money security interest in fixtures prevails if filed before the subsequent parties obtain rights in the realty.

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Therefore, the banks want to be kept updated to know if the fixtures can be removed by a creditor with priority to repay the debt owed to them by MM. The bank wants to know if the fixtures were filed before the interests in the realty, if so, then they may be at risk of having the large screens removed from the buildings which would lessen the buildings value. The Banks should not have to worry because MM's products seem to be installed in already build factories (monitors on the walls) so it is unlikely any fixture filing of the screens would have taken place before the mortgages were filed.