The “Strong-Arm” Power

- § 544 provides bankruptcy trustee with special status
  - § 544(a)(1): hypothetical “lien creditor”
  - § 544(a)(2): “unsatisfied execution creditor”
  - § 544(a)(3): “bona fide purchaser” of debtor’s land
- § 544(a) then gives trustee the power to avoid a transfer that these “hypothetical” persons could avoid under state law (e.g., § 9-317(a)(2)(A))

Problem 30.1(a)

- You are Chapter 7 trustee for Gargantuan Industries, Inc. (“Gargantuan”)
- 1 year ago, Bank financed Gargantuan’s purchase of new machinery, and took PMSI in it
  - Bank officer’s assistant “filed” the UCC-1 by putting it in the Bank’s loan file, rather than actually filing it in the UCC records at the Secretary of State’s office
  - Bank discovers the mistake, and files the UCC-1, 1 week after Gargantuan filed for bankruptcy

Problem 30.1(a): Can Trustee Avoid Bank’s SI in the collateral?

A. No; Bank’s PMSI was automatically perfected
B. No; Bank can still file its UCC-1 and thus perfect its SI
C. Yes (Bank was unperfected on the bankruptcy petition date)
Under Article 9, a lien creditor would take priority over an unperfected SI [§ 9-317(a)(2)(A)]. Trustee can thus set aside (avoid) Bank’s SI in the machinery [§ 544(a)(1)].

The Strong-Arm Clause

Outside of bankruptcy, Article 9 says that an unperfected SI still has priority over the claims of unsecured creditors [§ 9-201(a)]. If trustee represents unsecured creditors, then why should bankruptcy law give the trustee better rights than the unsecured creditors themselves would have?

Strong-Arm Power: Rationale

Aids administration of troubled debtors
- If trustee can assert rights of judgment lien creditor, creditors need not “race to the courthouse” (which may push debtor into bankruptcy even faster)
- Unsecured creditors may thus “cut debtor more slack” or “work with” the debtor, perhaps allowing debtor to resolve its difficulties without bankruptcy

Is this realistic?

Problem 30.1(a)

Problem 30.1(b)

What if the Bank had discovered the mistake, and had filed its UCC-1, the day before Gargantuan filed its bankruptcy petition?
- Trustee can’t use § 544(a) to set aside SI
- Trustee’s “hypothetical judgment lien” arose on date that Gargantuan filed its bankruptcy petition
- On that date, Bank’s SI was perfected, so Bank would have priority under § 9-317(a)(2)(A)
Problem 30.1(c)

- Another creditor, Torgeson, has a SI in Gargantuan’s front-loaders
  - Filed UCC-1 identifies the debtor and describes the collateral, but lacks the debtor’s mailing address
- Can Trustee avoid Torgeson’s SI in the front-loaders?

Problem 30.1(c)

- Torgeson’s UCC-1 filing effective despite missing info [§ 9-520(c)]
  - Torgeson’s SI was thus perfected, has priority over Trustee [§ 9-317(a)(2)(A)]
  - Even if a reasonable purchaser could have been misled by the missing info [§ 9-338], this still wouldn’t protect the trustee (who is not a “reliance” creditor)

Problem 30.1(d): Can Trustee Avoid Glasco’s SI in the collateral?

- Another creditor, Glasco, has a SI in Gargantuan’s equipment
  - Glasco’s UCC-1 was filed on July 15, 2008
  - Bankruptcy petition date: April 15, 2013
  - It is now October 15, 2013, and Glasco still hasn’t filed a continuation statement

A. Yes, b/c Glasco’s SI is now unperfected
B. No, b/c Glasco’s SI was still perfected on the date of the bankruptcy petition
§ 9-515(c) [Lapse and continuation of financing statement.] The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d). Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. *If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.*

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**Problem 30.1(d)**

- Glasco’s perfection has now lapsed (b/c more than 5 years have passed since filing)
  - But, Glasco’s SI (even though it is now unperfected) was still perfected on April 15 (when Trustee became “lien creditor”)
  - Glasco thus has priority [§ 9-317(a)(2)(A)]
  - Retroactive loss of perfection in § 9-515(c) doesn’t operate in favor of “lien creditors”!

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**Problem 30.1(f)**

- Bank has PMSI in a luxury automobile used by Gargantuan’s executives
  - Granted April 6, when Gargantuan bought car
  - On April 15 (petition date), the application for a certificate of title was sitting on desk at Bank
  - April 25: Bank delivered application to DMV, which then issued a title certificate reflecting Bank’s lien on the car

**Problem 30.1(f): Can Trustee Avoid Union Bank’s SI in the Car?**

A. Yes; lien creditor would have priority over Bank’s unperfected SI outside of bankruptcy
B. Yes; filing application w/DMV violated the automatic stay
C. Both A and B
D. No; Bank has PM priority
• In Problem 30.1(f), Trustee cannot use strong-arm power to avoid Bank’s security interest
  – § 9-317(e) permits a PM secured party to file UCC-1 within 20-day grace period, to obtain relation-back priority over intervening lien creditors
  – Title certificate statutes also have internal “relation-back” priority rules [e.g., RSMo. § 301.600: 30 days to file application for title certificate; once issued, certificate relates back to date of attachment]
  – § 9-311(b): compliance w/certificate of title statute is equivalent to filing for purposes of § 9-317(e)

§§ 544(a), 546(b), and the Stay

• Ordinarily, a post-petition act to perfect a SI (e.g., filing a UCC-1) would violate the automatic stay [§ 362(a)(4)]
  • Here, exception to the stay applies [§ 362(b)(3)]
    – Code doesn’t stay act of perfection to the extent trustee’s avoiding power is subject to § 546(b)
    – § 546(b) makes trustee avoiding powers subject to state law relation-back priority rules!