

BANKING LAW ALERT

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Jackson Offices
105 S. Highland Avenue
Jackson, TN 38301
and
209 E. Main Street
Jackson, TN 38301
P 731.423.2414

Memphis Office
50 N. Front Street, Ste. 610
Memphis, TN 38103
P 901.333.8101

Thomas H. Rainey, of Counsel
Jerry D. Kizer, Jr.
Russell E. Reviere
William C. Bell, Jr.
John D. Bureson
Laura A. Williams
Robert O. Binkley, Jr.
R. Dale Thomas
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W. Chris Frulla
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Gregory D. Jordan, of Counsel

AREAS OF PRACTICE

Timing Can Be Everything

In our fast paced world, timing *can* be everything. Bankers and attorneys often say that "time is of the essence," and that is very true when a lender is filing UCCs and other security instruments. Not only is it essential for a lender to promptly comply with state laws so as to have priority over subsequent liens, but a lender also should be mindful of timing issues in the event of a bankruptcy filing by the borrower down the road.

If a lender fails to perfect its security position within certain time frames established by the Bankruptcy Code, a bankruptcy trustee may be able to set aside the filing as a "preference." Section 547 of the Bankruptcy Code is commonly used by bankruptcy trustees to recover money for the bankruptcy estate from creditors who receive payments on old debts within the 90 days prior to the bankruptcy filing (the "Preference Period").

The same Bankruptcy Code section gives the bankruptcy trustee a basis to petition the court under certain circumstances to set aside lien filings made within the Preference Period. The trustee has this right because a debtor's conveyance of a security interest in property is a transfer of property that can be treated as a preference if made within the Preference Period. Just like an unsecured creditor may have to pay money back that it receives from the debtor within the Preference Period, a secured creditor also may find its lien avoided and find itself treated as an *unsecured* creditor, rather than a secured creditor.

For purposes of the preference statute (section 547), the key factor is the date on which the transfer of the security interest is "made." A lender is in the best position when the credit is advanced and the proper security instrument is filed (or "perfected") simultaneously or immediately following the execution of the security instrument.

Pursuant to section 547(e), a transfer is **made** for purposes of the preference analysis at the time that the transfer takes effect between the debtor and the lender, if the transfer is "perfected" at the same time or within 30 days thereafter. If the security interest is perfected after this 30-day period, the Bankruptcy Code treats the transfer as being **made** at the time of perfection of the security instrument. In other words, if the lender delays in getting a security instrument filed, an argument can be made

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that the transfer of the security instrument was a transfer in connection with an old debt, referred to in the statute as an "antecedent debt." If the security instrument is perfected beyond this 30-day period and within the Preference Period, the bankruptcy trustee may be able to have the lien set aside as a preference.

In a situation where it has been more than 30 days since the security instrument was signed, and a lender still has not perfected and a bankruptcy case is filed, the Bankruptcy Code treats the transfer of the security instrument as being **made** immediately before the filing of the case, which, of course, is within the Preference Period. (Note that subsection 547(e)(3) provides that a transfer is not made until the debtor has acquired rights in the collateral).

There is an exception to the preference statute for what is referred to as an "enabling loan." Under Bankruptcy Code section 547(c)(3), a trustee may not avoid a transfer of a security interest in property acquired by the debtor if new value (such as a new loan) is given by the creditor at the time or after the security instrument is signed to enable the debtor to purchase the collateral, and the new value is actually used by the debtor to purchase the collateral, and the security instrument is perfected by the 30th day after the debtor receives possession of the collateral.

In addition to possible preference actions, a bankruptcy trustee also has certain "strong arm powers" under Bankruptcy Code section 544. If a lender has not taken the necessary steps to perfect its security instrument properly prior to a bankruptcy filing, the trustee likely will be able to avoid the lien, even though there is a valid security instrument between the lender and the debtor.

Also note that in a chapter 11 bankruptcy case, where no trustee has been appointed, a debtor in possession has the same authority as a bankruptcy trustee, that is to bring a preference claim and to attempt to avoid a lien under Bankruptcy Code section 544.

So, to return to our initial observation, timing is indeed of the essence when perfecting security instruments. Timely filing (thus perfection) can be the difference between an effective lien filing and an unsecured status. Compliance with perfection procedures can be tedious and time consuming, but it is essential to effective lending.

**This brief article is intended to give our readers a working overview of the referenced bankruptcy statutes and how they affect everyday lending practices. It is not intended as an exhaustive analysis of the various issues that can occur. The statutes contain provisions that are not discussed in this article as our immediate focus here is the limited issue of timing concerns with regard to perfection of security interests.

NEW LAW REGARDING NOTARIES

Effective April 6, 2015, a recent amendment by the Tennessee Legislature changes the requirements for notaries. As you may recall, starting last October, notaries public were required to maintain a "well-bound book" as a record of all of the notaries public's acts and attestations. The book had to be kept regardless of whether the notary received a fee or compensation for his or her services.

The amendment no longer requires a notary to maintain the book so long as the notary does not receive a fee for said services. For employees of a financial institution, a record of the services of the notary is required if there is a fee charged by the notary or if the bank has a written policy that makes such records a record of the financial institution. Such records of the bank are governed by the Financial Records Privacy Act in Tennessee or the Federal Right to Financial Privacy Act of 1978, as applicable.



William C. Bell, Jr.
wbell@raineykizer.com



Laura A. Williams
lwilliams@raineykizer.com



Charles C. Exum
cexum@raineykizer.com



Adam C. Crider
acrider@raineykizer.com

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