

"Tomato, Tomahito"

A Security Agreement with an Incorrect Debtor Name Passes Muster to Create a Security Interest

KEY POINTS

A recent bankruptcy court decision highlights the importance of correctly identifying debtors in security agreements, UCC-1 financing statements, and related documents.

While the First to The Finish court held that slight discrepancies in the debtor's name might be acceptable in a security agreement, other courts may rule differently and, in any event, the same likely won't hold true for UCC-1 financing statements.

Creditor diligence is crucial in ensuring that a security interest is valid and properly perfected!

A TRADE CREDITOR CAN PROTECT ITSELF AGAINST COLLECTION RISK BY OBTAINING A SECURITY INTEREST IN ITS CUSTOMER'S ASSETS TO SECURE OBLIGATIONS OWING TO THE CREDITOR. ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE ("UCC") GOVERNS THE CREATION AND PERFECTION OF A SECURITY INTEREST IN PERSONAL PROPERTY. ARTICLE 9 REQUIRES PROPER IDENTIFICATION OF THE DEBTOR AND THE RELEVANT COLLATERAL TO PUT OTHER POTENTIAL CREDITORS ON NOTICE OF THE EXISTENCE OF A SECURITY INTEREST.

UCC Article 9's requirements can be quite strict. For example, courts have held that a security interest is not properly perfected where there is even the slightest difference between a debtor's correct legal name and the debtor's name on a UCC-1 financing statement. Interestingly, though, a recent decision by an Illinois bankruptcy court in the Chapter 11 case of *In re First to The Finish Kim and Mike Viano Sports, Inc.* held that the same level of strictness doesn't necessarily apply to identifying the debtor in a security agreement. In *First to The Finish*, the bankruptcy court held that the debtor's lender had a valid security interest even though the debtor's name on the relevant loan documents, including the security agreement, differed from the debtor's correct legal name.

But creditors shouldn't rely on the *First to The Finish* decision as an excuse to be complacent! While a slightly incorrect debtor name in a security agreement may pass muster to create a security interest, a creditor's use of that same incorrect name in the UCC-1 financing statement might be fatal to the perfecting that security interest. And, it's very possible another court might rule differently than the *First to The Finish* court regarding the necessity for

using a debtor's correct name in a security agreement. Best practice is to avoid the problem in the first instance. A secured creditor should do its diligence and monitor its customers both at and after the inception of a security interest. Otherwise, the creditor risks being stuck with an unsecured claim after avoidance of its security interest.

BACKGROUND REGARDING THE UCC'S FILING REQUIREMENTS

A trade creditor seeking to obtain a valid, perfected and enforceable security interest in its customer's personal property must comply with UCC Article 9. First, a creditor must properly create a security interest in its customer's property that will serve as collateral securing payment of the creditor's claim. Pursuant to UCC § 9-203, a security interest is created by the customer's execution of a security agreement that adequately describes the creditor's collateral by category or type. A collateral description such as "all of the debtor's present and future accounts, inventory, equipment, and general intangibles and all cash and non-cash proceeds thereof," would suffice; a description such as "all of the debtor's assets" will not suffice.

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Under UCC § 9-203(1), a security interest attaches to collateral “when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones attachment.” UCC § 9-203(2) further states that a security interest becomes enforceable against the debtor and third parties if value has been given, the debtor has rights in the collateral or the right to transfer rights in the collateral and, as discussed in the *First to The Finish* decision, “the debtor has authenticated a security agreement that provides a description of the collateral.”¹ UCC § 9-203 does not specifically provide any requirements for identifying the debtor.

A security interest in personal property must be perfected according to UCC Article 9’s requirements. A creditor frequently perfects a security interest in a debtor’s personal property by filing a UCC-1 financing statement in the appropriate filing office. According to UCC § 9-503(a)(1), a UCC-1 financing statement must, among other things, identify the debtor by its correct legal name as stated in the records of the state of the debtor’s organization. The comments to UCC § 9-503 also state that correctly identifying the debtor’s name “is particularly important” since “those who wish to find financing statements search for them under the debtor’s name.” UCC § 9-506(a) provides that a UCC-1 financing statement that “substantially” complies with UCC Article 9’s requirements is effective even if it contains minor errors or omissions, unless they make the financing statement “seriously misleading.” UCC § 9-506(b) further provides that a financing statement is “seriously misleading” if it fails to sufficiently state the debtor’s correct legal name as provided in UCC § 9-503(a).

Bottom line, getting the debtor’s name right on a UCC-1 financing statement is an absolutely critical part of perfecting a security interest. But as illustrated by the *First to The Finish* decision, a creditor may have more wiggle room regarding the debtor’s name in the underlying security agreement.

RELEVANT BACKGROUND REGARDING THE *FIRST TO THE FINISH* DECISION

The debtor began operating in the late 1980s as a retailer of track and field supplies, footwear, apparel, equipment and accessories. While the debtor’s owners and the nature of the debtor’s business never changed, the debtor operated under a number of different names and legal entities over the course of its existence. A chronological summary of the debtor’s entity changes and loan documentation is below:

- December 7, 1988–“First to The Finish Kim and Mike Viano Sports, Incorporated” is registered with the Illinois Secretary of state.
- December 24, 1992–A first security agreement is executed by CNB Bank & Trust, N.A. (CNB) and the debtor’s owners (on behalf of the debtor).

- May 2, 1994–“First to The Finish Kim and Mike Viano Sports, Incorporated” is involuntarily dissolved.
- December 20, 1999–“First to The Finish Kim and Mike Viano Sports, Inc.” is registered with the Illinois Secretary of State.
- October 22, 2014–A second security agreement is executed by CNB and the debtor’s owners (on behalf of the debtor).
- May 17, 2018–Two notes are executed evidencing the debt owed to CNB along with the other relevant loan documents.

On October 7, 2020, the debtor filed its Chapter 11 case. On March 3, 2021, CNB filed a proof of claim asserting an approximately \$9.7 million secured claim. In support of its claim, CNB attached the following:

1. A promissory note dated May 17, 2018 for \$6,500,000.00, showing the borrower as “First to The Finish Inc.”
2. A business loan agreement referencing a loan dated May 17, 2018 and a change in terms agreement referencing a loan dated May 17, 2018, with both documents showing the borrower as “First to The Finish Inc.”
3. A promissory note dated May 17, 2018 for \$2,000,050.00, showing the borrower as “First to The Finish Inc.”
4. A business loan agreement referencing a loan dated May 17, 2018 in the amount of \$2,000,050.00 to “First to The Finish Inc.”
5. A security agreement dated October 22, 2014, showing the borrower as “First to The Finish Inc.”
6. A security agreement dated December 24, 1992, showing the borrower as “First to The Finish Kim and Mike Viano Sports, Incorporated.”
7. A UCC-1 financing statement dated January 4, 1993, showing the borrower as “First to The Finish Kim and Mike Viano Sports, Inc.” that was continued several times.
8. Commercial guaranties signed by the debtor’s owners guarantying the indebtedness of “First to The Finish Inc.”

The Chapter 11 trustee appointed in the debtor’s bankruptcy case and one of the debtor’s suppliers challenged the validity of CNB’s security interest. They argued that CNB’s security interest had not attached to CNB’s collateral and therefore, CNB’s security interest was not properly perfected. The challenging parties claimed the debtor had never authenticated CNB’s security agreements because virtually all of CNB’s loan documents, including the 2014 Security Agreement, contained an incorrect legal name for the debtor. While the debtor’s correct legal name as of the bankruptcy filing was “First to The Finish Kim and Mike Viano Sports Inc.,” all of CNB’s loan documents, including the 2014 Security Agreement, identified the debtor as “First to The Finish Inc.”²

CNB responded that its security interest attached prior to the Chapter 11 case based on the 2014 and 1992 security agreements and therefore, CNB properly perfected its security interest via its UCC-1 financing statement filed in 1993 and periodically continued. Notably, the UCC-1 financing statement identified the debtor by its correct legal name.³

THE BANKRUPTCY COURT'S DECISION

The bankruptcy court held that CNB held a valid and perfected security interest notwithstanding the mismatching debtor names in the loan documents, including the 2014 security agreement. The court noted that UCC Article 9 has two requirements for a creditor to claim a security interest in a debtor's personal property with priority over third parties: attachment and perfection.

Specifically with respect to attachment, the bankruptcy court noted that under UCC § 9-203 (as adopted by Illinois), attachment occurs when, among other things, "the debtor has authenticated a security agreement that provides a description of the collateral." The bankruptcy court observed that while a debtor must authenticate a security agreement to create a security interest against the debtor, UCC § 9-203 does not specifically require the debtor to be identified by its correct legal name. Moreover, neither the parties nor the court itself identified any case law requiring the debtor's correct legal name to be in the security agreement for purposes of attachment under the UCC. As such, the court relied on case law outside of the UCC context that including a party's trade name or other incorrect name in a contract does not necessarily preclude enforcement of the contract.

In light of this, the bankruptcy court concluded that the dissimilarity between the debtor's correct legal name and the debtor's name on the parties' 2014 Security Agreement and other loan documents does not preclude authentication and attachment of CNB's security interest. The Court noted that the names used in the 2014 Security Agreement and on the loan documents were not meaningfully different since they all included "First to The Finish." Also, regardless of the debtor's correct legal name and the debtor's incorrect name on the relevant loan documents, there was a single business entity owned by the same individuals and engaged in the same business throughout CNB's and the debtor's relationship, the same people (the debtor's owners) signed all of the loan documents on behalf of the same operating business entity and that same business entity received and used the loan proceeds. As such, the Court concluded that CNB's claim against the debtor was secured under the 2014 Security Agreement and other loan documents. **BC**

1. UCC § 9-203 provides alternatives to the authenticated security agreement condition quoted above. However, those alternative conditions were not relevant in the First to The Finish decision and typically not relevant to trade creditors generally. Therefore, they are not discussed in this article.

2. While the 1992 Security Agreement executed by the debtor's predecessor had properly identified the debtor, the challenging parties contended that agreement was no longer viable following the predecessor's dissolution.

3. The dispute between the parties also involved other issues. However, this article focuses solely on the attachment of CNB's security interest despite the discrepancy between the Debtor's correct legal name and the name used in the security agreement and other loan documents.



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