Bankruptcy & Creditors' Rights Bulletin: October 2013
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The Bankruptcy and Creditors' Rights Bulletin provides an analysis of legal issues, recent court decisions and significant changes in bankruptcy and creditors' rights law.

Below are the articles for the October issue. To view, click on the appropriate title and you will be brought to the full version of the article below.

1. Notable Amendments to UCC Article 9
2. Non-Compete Provisions Solely Seeking Specific Performance Held Non-Dischargeable in Bankruptcy

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NOTABLE AMENDMENTS TO UCC ARTICLE 9

The 2010 Amendments to Article 9 of the Uniform Commercial Code went into effect in most states as of July 1, 2013. There were several important statutory changes:

How to Identify an Individual Debtor

1. Prior Law: The prior version did not provide any guidance as to the sufficiency of an individual debtor’s name. It only provided that the financing statement sufficiently provided the name of the debtor if it provided the “individual name” of the debtor.

2. New Law: The 2010 Amendments provide states with two alternatives to sufficiently identify the name of an individual debtor in a financing statement:

a. Alternative A, the “only if” approach requires that if the debtor has an unexpired driver’s license, the debtor’s name as it appears on the driver’s license must be used on the financing statement. “Only if” the debtor does not have an unexpired driver’s license should the debtor’s individual name (legal name), or surname and first personal name be used.

b. Alternative B, the “safe harbor” approach provides that any of the following shall
be sufficient: (a) the debtor’s name exactly as it appears on the debtor’s unexpired driver’s license issued by the resident state; (b) the individual name of the debtor (legal name); or (c) the debtor’s first personal name and surname.

Note: For both Alternative A and B, if the state has issued the debtor multiple driver’s licenses and all are unexpired, the name on the driver’s license most recently issued should be used.

3. Practical Effect: States that have adopted the 2010 Amendments vary between Alternative A and Alternative B. See Annex A. When filing financing statements, secured parties should be aware of which Alternative has been selected in the jurisdiction they are filing in.

For those jurisdictions that have selected Alternative A, the secured parties must be vigilant as to when a debtor’s driver’s license expires or if the name on the driver’s license has changed. Further, for both Alternatives, the statute does not provide guidance as to the difference between a debtor’s individual name and his or her surname and first personal name; therefore, it is highly advised that if the option to choose the debtor’s name exists, that the debtor’s legal name be used. Failure to properly identify the debtor could result in the security interest being unperfected.

How to Identify a Corporate Debtor

1. Prior Law: The prior version requires that a financing statement provide the name of the debtor “indicated on the public record of the debtor’s jurisdiction of organization.”

2. New Law: The 2010 Amendments clarify which public record to rely upon. The name that appears on the company’s public filing with the relevant State or with the United States to form the organization—the “public organic record”—should be used to identify the name of a registered organization. The public organic record is a “record consisting of the record initially filed with the State or the United States to form or organize the organization and any record filed with or issued by the State or the United States which amends or restates the initial record.”

3. Practical Effect: Secured parties should require organizations to provide a copy of its most recent “public organic record” to ensure that the debtor’s name is sufficiently identified on the financing statement.

Note: A certificate of good standing is not a public organic record as defined by the 2010 Amendments, and thus, should not be relied upon.

Governing Law

1. Prior Law: Under the 2001 version of Article 9, when a debtor changed the State of his or her residence, or a business organization change its state of formation, after perfecting a security interest, the security interest remained perfected for up to 4 months, but only on the collateral in which the security interest was properly perfected at the time of the change of location.

2. New Law: The 2010 Amendments allow for perfection of a security interest that
attaches to collateral *newly acquired* within the 4 months after a change in the debtor’s location if the creditor has previously taken steps that perfected the security interest in the debtor’s original state.

3. Practical Effect: The 2010 Amendments are more beneficial to creditors; however, creditors are still advised to perfect their security interest by filing in the new jurisdiction as soon as possible, and definitely before the expiration of the 4 months after the debtor changes locations.

NON-COMPETE PROVISIONS SOLELY SEEKING SPECIFIC PERFORMANCE HELD NON-DISCHARGEABLE IN BANKRUPTCY

In *Dutch Pharmacies, Inc. v. Amy C. Weathers*, 465 B.R. 782 (Bankr. N.D. Miss. 2011), the question presented was whether an employee could file a Chapter 7 bankruptcy, not schedule her employment agreement containing a non-compete clause as an executory contract, not tell her employer about her bankruptcy, continue with her employment, and then 17 months after the bankruptcy was over claim that because of her bankruptcy she was no longer bound to the non-compete clause in her employment contract. The Court said no.

**Important Lessons:**

1. Executory contracts should be scheduled and dealt with in bankruptcy. Here the debtor did not do so and the contract was found to flow through the bankruptcy unaffected.

2. Consistent with this analysis, the Bankruptcy Court noted that Ms. Weather’s liability under the non-compete clause of her employment contract did not arise until she terminated her employment with Dutch, long after the bankruptcy case terminated, and, thus, the Court found that her liability was not subject to discharge as no claim existed at the time she filed her Chapter 7 case.

3. The Court also found relevant that the non-compete provision at issue did not prescribe any form of monetary damages, whether compensatory or liquidated, but was enforceable solely by specific performance. On this analysis, it may be possible that, even if an employment agreement (or covenant not to compete) is scheduled and rejected in a bankruptcy proceeding, a non-compete provision providing only for specific performance may not be considered a dischargeable claim, and thus, would still be enforceable. *See, e.g., Sheerin v. Davis*, 3 F.3d 113 (5th Cir. 1993).

Note: Drawing on this last point, employers considering covenants not to compete with key employees should seek advice on the use of specific performance as the sole or principal remedy for breach. By so doing, they may improve their argument that such clauses should survive the bankruptcy of the employee.

Where the employer is aware of the employee’s bankruptcy, execution of a new employment agreement after the employee’s bankruptcy is recommended as a way to avoid disputes of the survival of the non-compete provisions of prior
employment agreements.

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