IN THE UNITED STATES BANKRUPTCY COURT FOR THE
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

IN RE:

W. J. RUNYON & SON, INC. CASE NO. 8600304WC

CROCKER NATIONAL BANK
vs.
W. J. RUNYON & SON, INC.

MOTION NO. 86108

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Edward Ellington, Bankruptcy Judge

ORDER ON "COMPLAINT FOR DECLARATORY RELIEF AND RELIEF FROM THE AUTOMATIC STAY OR, IN THE ALTERNATIVE, FOR DECLARATORY RELIEF AND ADEQUATE PROTECTION" FILED BY CROCKER NATIONAL BANK

THIS MATTER came on for hearing on Crocker National Bank's Complaint for Declaratory Relief and Relief from the Automatic Stay or, in the Alternative, for Declaratory Relief and Adequate Protection. After

examining the facts and considering the same, the Court finds that Crocker National Bank's requests are not well taken and should be denied. The Court finds that Crocker National Bank does not have a valid, perfected security agreement in property of the Debtor's estate and thus, is considered to be a general unsecured creditor who is not entitled to relief from the automatic stay nor adequate protection payments.

STATEMENT OF THE CASE

W. J. Runyon & Son, Inc. (Runyon) is a Mississippi corporation which was formerly engaged in the road construction business. Runyon filed a voluntary petition under Chapter 11 of the Bankruptcy Code on February 18, 1986. Since the filing of the Chapter 11 petition, Runyon has continued operation of the business as a debtor-in-possession.

Crocker National Bank (Crocker) is a national bank with its principal place of business in San Francisco. Recently, Crocker merged into Wells Fargo Bank. Pursuant to the merger agreement, this action may proceed in the name of Crocker. Crocker contends that although the Debtor's schedules listed it as unsecured, it is a secured creditor. Crocker alleges that Runyon owes it a principal indebtedness of approximately $3,780,000 and that Crocker holds a

perfected, enforceable security interest in equipment, vehicles, accounts receivable and contract rights. Crocker further contends that it has a valid security agreement and properly filed financing statements and that Runyon is in default under the $3,780,000 note.

On February 25, 1986, Crocker filed a "Complaint for Declaratory Relief and Relief From the Automatic Stay or, in the Alternative, for Declaratory Relief and Adequate Protection." Before Crocker's complaint could be determined by the Court, the Debtor filed a motion requesting use of cash collateral. After a hearing, this Court entered an Order allowing the Debtor's use of cash collateral on March 17, 1986. The cash collateral order assumed three creditors, Credit Alliance Corporation, Crocker National Bank and The American Bank, were all secured creditors until their status could later be determined by the Court. Therefore, the order not only allowed the use of cash collateral but ordered adequate protection payments to these three creditors. On March 18, 1986, an Amended Order allowing use of cash collateral was entered by the Court which only established the exact amounts of adequate protection payments to each of the three creditors.

On March 20, 1986, Runyon filed an Answer to Crocker's Complaint.

On May 6, 1986, the Court entered on Order extending the Order allowing use of cash collateral.

On June 20, 1986, the Debtor filed an Amended Answer to Crocker's Complaint.

Also on June 20, 1986, Crocker's Complaint came on for hearing before this Court. Attorneys for both parties appeared ready for trial and testimony was given and evidence submitted. At the conclusion of the hearing, a schedule was made for each of the parties to submit briefs for the Court's consideration, and briefs were timely filed. Crocker also filed a "Motion to Strike Brief or Supplement the Record."

During the course of the trial, Crocker submitted numerous documents showing the loan history of Runyon to substantiate its theory of the case that the parties intended the loan to be secured. Counsel for Runyon objected that the loan agreement was clear on its face and that the documents should not be admitted to show the intent of the parties. In deciding the case, the Court did consider the documents offered by Crocker and objected to by Runyon.

Although not a part of the record, it was at the request of the parties that the Court withheld its opinion for an extended period of time while the parties attempted to reach a settlement. The attempt at settlement failed and the Court is now called upon to render an opinion.

As mentioned earlier, Crocker is a national bank with its principal place of business in San Francisco. Recently, Crocker merged into Wells Fargo Bank. Pursuant to the merger agreement, this action may proceed in the name of Crocker.

Runyon is a Mississippi corporation which was formerly engaged in the road construction business. Runyon filed a voluntary petition under Chapter 11 of the Bankruptcy Code on February 18, 1986. Since the filing of the Chapter 11 petition, Runyon has continued operation of the business as a debtor-in-possession.

W. J. Runyon, Jr. has been the President and chief operating officer of Runyon for approximately 20 years. He owns 90% of the stock and is responsible for the overall operations, including obtaining financing and credit.

Runyon has been indebted to Crocker Bank, or a predecessor, for approximately 15 years. During this time, Runyon was indebted to Crocker under several different loans and loan agreements. Crocker's loans to Runyon were always secured by equipment or equipment and receivables and its security interest was always perfected by security agreements and filed financing statements.

On June 28, 1983, Runyon's indebtedness to Crocker was consolidated into a "Revolving Credit

Note", (Plaintiff's Ex. 17), and a "Security and Loan Agreement", (Plaintiff's Ex. 18). Runyon was thereby authorized to borrow up to $5,000,000. The Note provided that Runyon agreed to pay to Crocker National Bank the principal sum of $5,000,000 or such lesser amount as equalled the outstanding balance of revolving loans.

This loan was also referred to as a "pooling of assets." Under this concept of credit, certain assets owned by Runyon were qualified or appraised and Crocker advanced money up to a stated percentage of the qualified value of the assets. Under guidelines, Runyon would ascertain the value of certain assets, such as receivables and equipment, and a percentage of the value would be advanced to Runyon by Crocker. The "pooling of assets" concept required that Runyon periodically submit appraisals of equipment and "borrowing base certificates." These certificates set forth the present value of eligible accounts receivable.

In connection with the negotiations which culminated in the "revolving credit" agreement, Runyon signed on March 18, 1983, (Plaintiff's Ex. 8) and on May 28, 1983, (Plaintiff's Ex. 13) two separate Security Agreements which provide, in part:

> . . . For valuable consideration, the receipt whereof is hereby acknowledged, (Runyon) hereby grants to Crocker National Bank . . . a

> security interest in the following described property together with any and all additions, replacements, accessions and substitutions thereto or therefor, any additional equipment of the debtor, whenever acquired and in any proceeds or products thereof. . .
>
> To secure payment of the indebtedness evidenced by this agreement and also of any and all other indebtedness, obligations and liabilities, direct or indirect, accrued or contingent, now existing or hereafter arising of debtor to secured party including, without limitation, future advances or other value or consideration furnished or to be furnished by secured party to debtor.

Both security agreements granted Crocker a security interest in construction equipment. Crocker actually had had a security interest in virtually the same equipment since 1980. However, the May 28, 1983, security agreement also gave Crocker a security interest in accounts receivable and contract rights.

Both security agreements were perfected by filing financing statements with the Secretary of State and the Chancery Clerk of Warren County. One financing statement was filed on March 18, 1983, (Plaintiff's Ex. 9) and another on June 13, 1983, (Plaintiff's Ex. 16).

By 1984, W. J. Runyon personally became dissatisfied with the "pooling of assets" concept. His dissatisfaction apparently arose from a concern about

the possible "run-off" accounts receivable during the winter months. If the accounts receivable were reduced due to winter slowdown, Runyon would be required to make a substantial payment to Crocker. As a result of his personal dissatisfaction, Runyon initiated discussions and negotiations with officers of Crocker to convert the indebtedness to a term loan.

Winston Hemby, Runyon's accounting officer, travelled to California and met with William Long, an officer of Crocker, to discuss converting the loan into a term note. Runyon also wanted to obtain the release of the retainages on contracting jobs. Also in 1984, Runyon and Hemby met with Harold Morris, an officer of Crocker, at Runyon's office in Vicksburg. Again, Runyon requested that the debt be converted to a term loan. Subsequently, these negotiations were resumed by Joe Taylor, an employee of Crocker, who lived in Memphis, Tennessee. Taylor had been an employee of Crocker for many years and was the bank officer who dealt directly with Runyon on most occasions.

The negotiations to convert the loan to a term loan continued over several months. Several letters were sent to Runyon indicating that Crocker was seeking to accommodate Runyon's request to "term out" the indebtedness. On August 20, 1985, Taylor sent Runyon a letter which reflected the agreement of the

parties and the credit approval of Crocker. The letter stated:

> This will confirm the continuation of your line of credit totalling $3,780,000 secured by a first security interest in certain construction equipment and all of the corporation's accounts receivable. This letter will answer your recent request on the retainage portion of the accounts receivable collateral. Crocker is agreeable to releasing its lien on retainages due you on various jobs in process. But will retain all rights as set forth in our present UCC-1 filing on all other categories of receivables.

Because of changes in Crocker management, the loan documents had not been prepared as of August 20, 1985. By this time, Jay Reinstra had been assigned as the account officer for the Runyon loan. When Reinstra received the initial documents, which consisted of an amended loan agreement and term note, from Crocker's Legal Department, he immediately forwarded them to Taylor who delivered the note and loan agreement to Runyon's office about August 27, 1985. Taylor discussed the terms of the amended agreement and note with Hemby. Runyon was not present.

During the discussions, Taylor told Hemby that Crocker intended to obtain new security agreements and UCC financing statements. Taylor left the "amended and restated term note" (Plaintiff's Ex. 28, Defendant's Ex. 2) and the "amended and restated term loan

agreement" (Plaintiff's Ex. 29, Defendant's Ex. 1) with Hemby. Subsequently, Runyon signed these documents and they were returned to Crocker. A few days later, Taylor received the new financing statements and security agreements from Reinstra. However, upon reviewing these, Taylor observed that their language included all present and hereafter acquired inventory and equipment. Taylor contacted Hemby and notified him that the security agreements and finance statements were being voluntarily returned to Crocker for revision because their language was too broad. Hemby agreed that the documents should be revised, and on September 9, 1985, Taylor returned them to Crocker.

Despite the fact that a new security agreement was not signed, both parties continued to presume that the loan was fully secured. Runyon did not at any time request that Crocker file a termination statement regarding the financing statements which were presently on file; Runyon did not request Crocker to release collateral or return titles to motor vehicles. In fact, Runyon received substantial correspondence from Crocker requesting appraisals of equipment and borrowing base certificates. He complied with these requests including obtaining a new appraisal on the secured equipment.

Prior to the time that Crocker could revise

the security agreement and financing statement and return them to Taylor, Runyon defaulted on the loan. Joe Taylor visited Runyon's office in Vicksburg to pick up principal and interest payments which were due. Runyon delivered an interest payment but later stopped payment on the check.

In December, 1985, Crocker demanded that payments be brought current. The bank also demanded current appraisals, current accounts receivable aging reports and current appraisals on machinery. Runyon complied and delivered all documents requested.

The loan agreement refers to collateral including equipment and accounts receivable. A list of the same equipment which had secured the Crocker debt for several years was to be attached to the agreement but was not. It is clear that the parties intended to sign new security agreements and financing statements. The failure to get Runyon to sign and deliver these documents was the result of a mistake by Crocker.

DISCUSSION

Runyon filed his Chapter 11 petition on February 18, 1986. Pursuant to the Bankruptcy Code, Runyon became a Debtor-in-Possession and along with this came certain rights, powers and duties.

Section 1107(a) of the Bankruptcy Code provides:

> §1107. Rights, powers, and duties of debtor in possession.
>
> (a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title,and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

Thus, Runyon, as debtor-in-possession, became the trustee for the bankruptcy estate.

Section 544(a)(1) of the Bankruptcy Code provides:

> §544. Trustee as lien creditor and as successor to certain creditors and purchasers.
>
> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--
>
> > (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

Section 544(a), sometimes referred to as the "strong-arm clause", provides the trustee with three different hypothetical standings. Section 544(a)(1) gives the trustee the status and powers of a hypothetical judicial lien creditor who hypothetically extends credit to the debtor at the time of the filing of the petition and who hypothetically obtains a judicial lien on all property of the debtor. Therefore, at the time of the filing of the petition, Runyon as debtor-in-possession/trustee became a judicial lien creditor as to all the property of the estate.

Uniform Commercial Code, §9-301(1)(b) and §75-9-301, Miss. Code of 1972, provide:

> Persons who take priority over unperfected security interests; rights of "lien creditor"
>
> (1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of
>
> (b) a person who becomes a lien creditor before the security interest is perfected;

Fundamentals of Bankruptcy Law[1] explains how the application of the strong-arm clause interrelates to UCC §9-301 and gives an illustration that is

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1 Treister, George M.; Trost, J. Ronald; Forman, Leon S.; Klee, Kenneth N.; Levin, Richard B. Fundamentals of Bankruptcy Law. American Law Institute-American Bar Association Committee on Continuing Professional Education, 1986.

helpful to the facts of this case. Fundamentals of Bankruptcy Law states:

> * * * Under Section 9-301(1)(b) of the Uniform Commercial Code, an Article 9 security interest, though valid as between the debtor and the secured party, is nevertheless junior to the rights of a creditor who obtains a judicial lien on the collateral before the security interest is perfected. Perfection under Article 9 usually occurs by the secured party's filing a financing statement or taking possession of the collateral. If perfection occurs before the judicial lien is obtained, no matter how long perfection was delayed, the secured party prevails over the judicial lien creditor.
>
> With this in mind consider the debtor who borrows money from a bank, giving a security interest in his equipment to secure the loan. The bank fails to perfect before the debtor files bankruptcy. The trustee may invalidate the security interest under Section 544(a)(1), for a creditor who hypothetically extended credit and obtained a judicial lien on the equipment at the time of the petition -- the security interest being then unperfected -- would defeat the security interest under U.C.C. §9-301(1)(b). But if the secured party filed a financing statement or otherwise perfected at any time before bankruptcy, even just before, the trustee would lose insofar as Section 544(a)(1) is concerned. On these facts the trustee's hypothetical judicial lien would not prime, or be treated as senior to, the perfected security interest under U.C.C. §9-301(1)(b).

Note that after the filing of the Chapter 11 petition, W. J. Runyon & Son, Inc. was not just a simple debtor but a debtor-in-possession taking on the duties of a trustee. Runyon's obligations are to the estate and to all creditors of the estate. Thus, Runyon has a duty to challenge the extent and validity of Crocker's alleged lien.

The important question is whether Crocker has a valid and enforceable security agreement and thus a perfected security interest which will prime a judicial lien creditor, the debtor-in-possession. The existence of a valid and enforceable security agreement is determined from the requirements for the creation of a security interest as set forth in the Uniform Commercial Code. Chapter 9, Title 75, Miss. Code of 1972, governs the creation, attachment and perfection of a security interest in personal property in the State of Mississippi.

§75-9-105(1)(l), Miss. Code of 1972, defines security agreement as follows:

> "Security Agreement" means an agreement which creates or provides for a security interest.

§75-1-201(37), Miss. Code of 1972, defines a security interest as follows:

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. . .

§75-9-203, Miss. Code of 1972, sets forth the formal requirements for attachment and enforceability of a security interest and provides as follows:

> (1) Subject to the provisions of section 75-4-208 on the security interest of a collecting bank and section 75-9-113 on a security interest arising under the chapter on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless
>
> (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and, in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and
>
> (b) value has been given; and
>
> (c) the debtor has rights in the collateral.
>
> (2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

Without actually quoting the lengthy code sections, note that §75-9-302, Miss. Code of 1972, sets forth when a financing statement must be filed in order to perfect a security interest and §75-9-402, Miss. Code of 1972, sets forth the formal requisites of a financing statement. Also, §75-9-403 sets forth what

constitutes filing and the duration of a filed financing statement.

In order for Crocker to have priority over the debtor-in-possession/judicial lien creditor, Crocker must have a valid and enforceable security agreement granting a security interest in Runyon's property. And, that security interest must be properly perfected by the filing of a financing statement.

Crocker contends that it has two previously filed financing statements which are valid and which perfect the August, 1985, loan agreement. This Court agrees that Crocker's two financing statements would be good to perfect a valid and enforceable security agreement if Crocker actually had a valid and enforceable security agreement granting a security interest. One financing statement was filed on March 18, 1983, (Crocker's Ex. 9) and the other was filed on June 13, 1983, (Crocker's Ex. 16).

§75-9-402, Miss. Code of 1972, provides:

> (1) . . . A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. . . .

§75-9-403, Miss. Code of 1972, provides:

> (2) . . ., a filed financing statement is effective for a period of five (5) years from the date of filing. . . .

Therefore, a financing statement may be filed before the security agreement is made and that filed

financing statement is valid for five years. The only way to void a financing statement is for the debtor to request of the creditor that it be terminated pursuant to §75-9-404, Miss. Code of 1972. Runyon did not request of Crocker that the financing statements be terminated and thus, the financing statements remained in effect. See Household Finance Corp. v. Bank Commissioner of MD, 235 A.2d 732 (1967); Chrysler Credit Corp. v. Community Banking Co., 395 A.2d 727 (1978); and In re Rivet, 299 F.Supp.374 (1969).

For the previously filed financing statements to perfect a subsequent security agreement, Crocker must have a valid and enforceable security agreement granting a security interest. In order for Crocker to have a valid and enforceable security agreement, all the following elements must be present:

> (1) Crocker must have a written agreement signed by the debtor granting a security interest in collateral;
>
> (2) A description of the collateral;
>
> (3) Value given by Crocker;
>
> (4) Debtor must have rights in the collateral.

See §75-9-203, Miss. Code of 1972.

After reviewing the August, 1985, loan agreement and other documents submitted into evidence at trial, the Court finds there is nothing to indicate

that elements (3) and (4) above have not been fulfilled. However, element (1), which requires a signed written agreement granting a security interest in the collateral is missing. Also, there is a question if element (2), which requires a description of the collateral, has been met. The loan agreement referred to collateral in an Exhibit which was to be attached to the agreement but was not. Simply stated, the loan agreement dated August 29, 1985, is just that, a loan agreement. It is not a security agreement. Thus, Crocker does not have a valid and enforceable security agreement and the debtor-in-possession/ judicial lien creditor will take priority over Crocker.

Crocker further contends that it had security agreements prior to the August, 1985 loan agreement and that they are still enforceable to grant Crocker a secured creditor status. This Court disagrees and finds that Crocker's previous security agreements were terminated by the August, 1985 loan agreement.

The loan agreement was prepared by Crocker and executed on August 29, 1985. Since the drafting of the agreement was done by Crocker, it is general contract law that the language of the agreement must be most strongly construed against the preparing party. See 17 Am.Jur.2d "Contracts" Section 276. Certain parts of the loan agreement (Plaintiff's Ex. 29,

Defendant's Ex. 1) clearly provide that the loan agreement constituted a new agreement and cancelled all prior agreements between Runyon and Crocker. Note these pertinent parts of the agreement:

> (a) Entire Agreement. This Agreement embodies the entire agreement and understanding between the parties hereto and supersedes all prior agreements and understandings relating to the subject matter hereof.
>
> Page 25, Sec. 12(a).
>
> (a) Term Loan Commitment. The Bank agrees, subject to and upon the terms hereof, to make a term loan (the "Term Loan") to the Debtor on the date of this Agreement, in one disbursement, in a principal amount not exceeding the aggregate principal amount of the Revolving Loans on said date. The proceeds of the Term Loan shall be immediately applied by the Bank to the repayment in full of the principal amount of the Revolving Loans then outstanding.
>
> Page 9, Sec. 2(a).
>
> (a) Debtor shall deliver, or cause to be delivered, to Bank:
>
> (1) A duly executed copy of this Agreement;
>
> (2) A duly executed copy of the Term Note;
>
> (3) A duly executed copy of the Security Agreement(s) and such UCC-1 or other financing statements as Bank may request;
>
> Page 11, Sec. (4)(a)(1)(2)(3).

Crocker terminated its previous security agreements by terms in its own agreement which it prepared. There is no language in the loan agreement which grants a security interest in collateral and thus, the loan agreement cannot be construed as a security agreement. A Crocker representative in California testified that he sent a new security agreement and financing statement to a Crocker representative in Tennessee to be forwarded for execution by the Debtor. The Tennessee representative testified that he did not have the Debtor sign the security agreement or financing statement in August, 1985, at the time of the execution of the new note and loan agreement. The Tennessee representative further testified that in September, 1985, he returned the unsigned security agreement and financing statement to the Bank in California because they were incorrect. No new security agreement or financing statement was ever executed by the parties pursuant to the loan agreement.

Numerous cases and other authority have been cited to the Court for its consideration concerning whether the August, 1985, loan agreement was a novation. Without actually listing the cases cited by both parties, the Court notes that the case law and secondary authority cited indicate that a novation is more of a question of fact than of law. In large part, a

novation depends on what the Court determines to be the intent of the parties when there is no clear expression of intent. Almost all of the authorities on novation deal with circumstances where there is no expressed agreement and the Court must work through the facts of the case to determine the intent of the parties.

There is no question of what the intent of the parties was in this case. There is an expressed, written agreement and the intent of the parties is exactly what they agreed to and signed.

In terms of equitable principles, it may seem harsh to find a creditor who thought it was secured as being unsecured, especially when the debt is as large as it is in the present case. Even though both parties may have intended the debt to be secured, the fact remains that a new agreement was executed which terminated all prior security agreements. Crocker, by testimony of its own representatives, stated that it had a new security agreement and financing statement to be executed by Runyon, but had failed to get the documents executed. Under the laws governing commercial transactions, Crocker cannot meet the technicalities necessary to achieve the status of a secured creditor. Crocker did not do what it intended to do, which was to secure its loan.

Runyon filed his Chapter 11 petition and as

stated earlier the debtor-in-possession/trustee became a judicial lien creditor. See §§1107 and 544 of the Bankruptcy Code. At the time the petition was filed, Crocker did not have a perfected security interest in the Debtor's property and the debtor-in-possession stepped in and took priority. Thus, Crocker is rendered an unsecured creditor.

The Court notes that Crocker filed a "Motion to Strike Brief or Supplement the Record" on August 27, 1986, along with its rebuttal brief. Crocker alleges in its motion that in Runyon's brief Runyon is claiming for the first time that a June 28, 1983, loan agreement constituted a novation and terminated an earlier security agreement and financing statement. This Court finds no reason to discuss at length the 1983 agreement due to its findings concerning the 1985 agreement. Even assuming, arguendo, for Crocker as to the 1983 agreement, the 1985 agreement still renders Crocker an unsecured creditor.

CONCLUSION

For the reasons set out herein, this Court finds that Crocker does not have a perfected security interest and is a general unsecured creditor. The Court further finds that Crocker, being an unsecured creditor, is not entitled to relief from the automatic

stay nor adequate protection payments.

THEREFORE, IT IS ORDERED that Crocker National Bank's Complaint for Declaratory Relief and Relief from the Automatic Stay or, in the Alternative, for Declaratory Relief and Adequate Protection should be and is hereby denied.

SO ORDERED, this the 18 day of May, 1987.

U. S. BANKRUPTCY JUDGE