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

IN RE:

DOUGLAS A. JENNINGS, INDIVIDUALLY, AND JENNINGS & ASSOCIATES, INC.

CASE NO. 861209JC

Petition to Disburse Funds filed by Jean S. East

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Edward Ellington, Bankruptcy Judge

OPINION AND ORDER ON "PETITION TO DISBURSE FUNDS" FILED BY JEAN S. EAST AND RELATED PLEADINGS

This cause came on for hearing on the "Petition to Disburse Funds" filed by Jean S. East; the "Response to Petition to Disburse Funds and Counterpetition for Disbursement of Funds" filed by Rankin County Bank; the "Response to Petition of Jean East to Disburse Funds" and "Petition to Disburse Funds to Rick Barron" filed by Richard A. Barron. Briefs were filed by the aforesaid parties as well as by the Trustee.

DISCUSSION

An Order of Relief was entered against Douglas A. Jennings, Individually, and Jennings & Associates, Inc. on August 19, 1985, pursuant to Chapter 11 of the Bankruptcy Code.

On March 13, 1986, James Mozingo was appointed as Trustee in the pending Chapter 11 bankruptcy.

Prior to the appointment of a Trustee, an Order had been entered on November 20, 1985, authorizing the then debtor-in-possession to sell a certain parcel of unimproved real estate for $115,000.00, from which approximately $89,400.00 was paid to the Rankin County Bank in satisfaction of a purchase money indebtedness; approximately $2,000.00 was paid to satisfy ad valorem taxes; and, the balance

of approximately $24,000.00 was ordered to be held in escrow, pending determination of claims asserted by various creditors and the Trustee.

The parties asserting claims to the money and a brief summary of the basis upon which they assert their claims are as follows:

1. The Rankin County Bank, which asserts that it is entitled to all of the funds because of an unpaid promissory note dated January 24, 1984, in the original principal amount of $85,000.00, plus accrued interest, which it claims is secured pursuant to a "dragnet clause" contained in a deed of trust dated January 27, 1984, between Jennings & Associates, Inc., as Grantor, and The Rankin County Bank, as Beneficiary. The deed of trust was filed for record with the Chancery Clerk of Rankin County, Mississippi, at 1:30 p.m. on February 10, 1984.

2. Jean East, who claims that the real property had been purchased by the Debtor with her money and that the property was being held in a constructive trust by the Debtor at the time the Order for Relief was entered on August 19, 1985.

3. Richard A. Barron, an architect, who asserts that he had performed architectural services in designing a building which was to be built on the property and that pursuant to Miss. Code Ann. §85-7-131

(1972), he was entitled to a lien on the property; that he had properly perfected it by filing a "Notice of Construction Lien" in the Office of the Chancery Clerk of Rankin County, Mississippi, pursuant to the said code section on June 17, 1985; and, suit to enforce his lien had been filed in the Circuit Court of Rankin County as provided by law on July 8, 1985.

4. The Trustee, who essentially asserts that this Court should not give effect to the "dragnet clause" in the deed of trust of The Rankin County Bank; that even if Jean East could establish a constructive trust, she cannot prevail against a bona fide purchaser for value without notice of the trust, and pursuant to §544 of the Bankruptcy Code the Trustee attains this status as of the date and time of filing of a petition and therefore the Trustee must prevail over East; and, that Richard A. Barron is not entitled to a construction lien because the building which he designed was never built upon the property.

The Rankin County Bank and Jean East take positions similar to that of the Trustee in opposing the claim of Richard A. Barron.

5. Richard Walker is a creditor of the estate who appeared at the hearing through counsel and assisted the Trustee.

A chronological sequence of events is helpful in considering this case.

Douglas A. Jennings was an insurance salesman who also advised people in regard to investing their money. Jean East was one of his clients. He had a history of borrowing money from The Rankin County Bank.

Jennings & Associates, Inc. was his corporation through which he apparently conducted most of his business. Investment funds from his clients, as well as insurance premiums which he earned as a salesman, were deposited into the corporation.

Previously, Jean East and Mr. Jennings had done business together on investing in an office building. In October or November, 1985, Mrs. East sent to Mr. Jennings $150,000.00 for him to invest for her. This money was placed into one of the bank accounts of Jennings & Associates, Inc.

At about the same time, Mr. Jennings had instituted applications with The Rankin County Bank for two separate loans. One loan application was for $81,600.00 which was to be used to help purchase the parcel of real estate involved herein. The other loan was to be used for "operating capital." Mr. Jennings originally asked for more than $85,000.00 but the loan was approved in the amount of $85,000.00.

Both loans were approved by the loan committee of The Rankin County Bank at the same time on January 19, 1984.

The promissory note evidencing the $85,000.00 loan for "operating capital" was dated January 25, 1984.

The promissory note evidencing the $81,600.00 loan for the purchase of the real estate was dated two days later on January 27, 1984.

Both of these notes showed the payor to be Jennings & Associates, Inc.

At the time the loan was closed on the $81,600.00 loan, Jennings & Associates, Inc. gave to The Rankin County Bank a deed of trust dated January 27, 1984, on the parcel of property involved herein which indicated that it was to secure the payment of the $81,600.00 indebtedness. It also contained a "dragnet clause" which will be set out in detail at a later point in this opinion and order.

The proceeds of the $81,600.00 loan, together with another $20,000.00 from a bank account of Jennings & Associates, Inc., was then used to purchase the real estate described in the deed of trust. The Grantee of the deed to the property was Jennings & Associates, Inc.

During this time Mr. Jennings entered into negotiations with an architect, Richard A. Barron, to provide architectural services to design a building to go on the property. Apparently, Jennings needed

architectural drawings and related documents in order to apply for construction and permanent financing. A written contract for architectural services was entered into between Jennings & Associates, Inc. and Richard A. Barron on January 15, 1984. Pursuant to the contract Mr. Barron did in fact prepare construction drawings and related documents which were used by Mr. Jennings for the purpose of attempting to gain financing and awarding a construction contract for a proposed building on the property. An invoice for his services dated June 13, 1985, in the total amount of $40,558.50 is included in the record and no issue was made of the fact that Mr. Barron did the work in preparing the drawings and related documents.

As previously noted, Mr. Barron filed a "Notice of Construction Lien" in the office of the Chancery Clerk on June 17, 1985, and filed suit in Circuit Court to enforce his lien on July 8, 1985, pursuant to Miss. Code Ann. §85-7-131 (1972).

No contract was ever entered into for the construction of a building and nothing was built on the property.

The deed of trust dated January 27, 1984, from Jennings and Associates, Inc. to the Rankin County Bank to secure the promissory note of the same date in the amount of $81,600.00 contained the following

language:

> WHEREAS, Debtor desires to secure prompt payment of (a) the indebtedness described above according to its terms and extensions thereof, (b) any additional and future advances with interest thereon which Secured Party may make to Debtor as provided in Paragraph 1, (c) any other indebtedness which Debtor may now or hereafter owe to Secured Party as provided in Paragraph 2 and (d) any advances with interest which Secured Party may make to protect the property herein conveyed as provided in Paragraphs 3, 4, 5 and 6 (all being herein referred to as the "Indebtedness").
>
> NOW THEREFORE, in consideration of the existing and future indebtedness herein recited, Debtor hereby conveys and warrants unto Trustee the land described below. . .
>
> . . .
>
> THIS CONVEYANCE, HOWEVER, IS IN TRUST to secure prompt payment of all existing and future indebtedness due by Debtor to Secured Party under the provisions of this Deed of Trust. . . .
>
> . . .
>
> IT IS AGREED that this conveyance is made subject to the covenants, stipulations and conditions set forth below which shall be binding upon all parties hereto.
>
> 1. This Deed of Trust shall also secure all future and additional advances which Secured Party may make to Debtor from time to time upon the security herein conveyed. Such advances shall be optional with Secured Party and shall be on such terms as to amount, maturity

> and rate of interest as may be mutually agreeable to both Debtor and Secured Party. Any such advance may be made to any one of the Debtors should there be more than one, and if so made, shall be secured by this Deed of Trust to the same extent as if made to all Debtors.
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> 2. This Deed of Trust shall also secure any and all other indebtedness of Debtor due to Secured Party with interest thereon as specified, or of any one of the Debtors should there be more than one, whether direct or contingent, primary or secondary, sole, joint or several, now existing or hereafter arising at any time before cancellation of this Deed of Trust. Such indebtedness may be evidenced by note, open account, overdraft, endorsement, guaranty or otherwise.
>
> . . .
>
> (Emphasis added)

The promissory note between the same parties dated January 25, 1984, in the principal amount of $85,000.00 contained a provision on its face which stated:

> Security: I am giving a security interest in:
>
> . . .
>
> collateral securing other debts with you may also secure this note.

The note dated January 25, 1984, also contained this language:

> Other Security - I agree that any present or future agreement securing any other debt I owe you will also secure the payment of this note.

Federal law controls bankruptcy proceedings, but state law must be used to determine the rights of the creditors making claims in this case. In re Gringeri Brothers Transportation Co., Inc. vs. Sherman, 14 B.R. 396, 399, (Bkrtcy. 1981).

The Mississippi Supreme Court has enforced "dragnet" clauses in deeds of trust in a variety of factual situations for more than sixty years. Coombs v. Wilson, 107 So.874 (Miss. 1926); Campbell Brothers v. Bigham, 115 So.395 (Miss. 1928); Holland v. Bank of Lucedale, 204 So.2d 875 (Miss. 1967); Trapp v. Tidwell, 418 So.2d 786, 792 (Miss. 1982); Whiteway Finance Company, Inc. v. Green, 434 So.2d 1351 (Miss. 1983); Walters v. M & M Bank of Ellisville, 218 Miss. 777, 67 So.2d 714 (Miss. 1953).

The Mississippi Supreme Court has excepted debts owed to third parties which were later acquired by the holder of a deed of trust. Hudson v. Bank of Leakesville, 249 So.2d 371 (Miss. 1971).

This Court is aware of at least three previous occasions when other judges on this Court have failed to fully enforce "dragnet" clauses in deeds of trust, all to no avail.

On February 2, 1983, a judge of this Court held that two promissory notes executed subsequent to the execution of a deed of trust containing a "dragnet"

clause were secured by the deed of trust, but that two promissory notes executed prior to the creation of the deed of trust were not secured by the deed of trust. In the Matter of Michael Joseph Fields; Michael Joseph Fields v. First Natchez Bank; Bkrtcy. No. 8002892WC, Adv. No. 810067WC (Bkrtcy. S.D.Miss., Feb. 2, 1983).

An appeal was taken. The District Court reversed the Bankruptcy Court and held that the two promissory notes executed before the deed of trust were secured by the deed of trust as well as the two promissory notes executed after the deed of trust. In the Matter of Michael Joseph Fields; First Natchez Bank v. Michael Joseph Fields; No. W83-0026(C) (S.D.Miss., March 14, 1983).

The case was then appealed to the U. S. Court of Appeals, Fifth Circuit. The Court of Appeals affirmed the U. S. District Court. Fields v. First Natchez Bank, (In Re Michael Joseph Fields), 719 F.2d 402 (5th Cir. 1983), (No. 83-4243, Oct. 18, 1983). The opinion of the Fifth Circuit was not published. However, this Court finds that the opinion is a good summary of the law on "dragnet" clauses in Mississippi and that the opinion is controlling in the case at bar. A copy of the Opinion is attached to this Opinion and Order as Appendix "A".

On August 25, 1983, a judge of this Court held that the "dragnet" clauses in two deeds of trust

were not enforceable because the parties and their wives did not intend for their homesteads to be given as security on certain business loans. First National Bank of Jackson v. Marcellus Quinn and Marvin Quinn d/b/a Quinn Brothers Saw Mill, (In the Matter of Marcellus Quinn and Marvin Quinn d/b/a Quinn Brothers Saw Mill), Ch. 7 Case Nos. 8102322JC and 8102323JC, Adv. Nos. 820203JC and 820204JC (S.D.Miss., Aug. 25, 1983).

An appeal was taken and this Court was reversed by the District Court. First National Bank of Jackson v. Marcellus Quinn and Marvin Quinn d/b/a Quinn Brothers Saw Mill, No. J83-0676(L) (S.D.Miss., Oct. 9, 1984). A copy of that opinion is attached as Appendix "B".

In his brief, the trustee cites the case of Matter of Ladner, 50 B.R. 85, 89-92 (Bkrtcy. 1985) in support of his position that the "dragnet clause" should not be enforced. That Opinion was entered by a judge of this Court on May 10, 1985. An appeal was taken and an Agreed Judgment was entered in District Court on June 4, 1985, expressly recognizing that the dragnet clauses in the bank's prepetition and post-petition deeds of trust and security agreements were valid and enforceable. First Mississippi National Bank v. Dickie Joe Ladner, No. J84-0889(B) (S.D.Miss., June 4, 1985).

Based on the plain, concise language in the deed of trust dated January 27, 1984, and the promissory note dated January 25, 1984, and the authorities previously cited, this Court finds that the promissory note dated January 25, 1984, is secured by the deed of trust dated January 27, 1984.

This Court makes no specific finding as to the assertion of Jean East that the real property had been purchased in part with her money by the Debtor and was being held in a constructive trust by the Debtor at the time the Order for Relief was entered on August 19, 1985.

Assuming, arguendo, that part of her money had been used for the down payment of the property and that the debtor was holding it in constructive trust for her, there is nothing in the record to show that at the time the Rankin County Bank made the loans and recorded its deed of trust;[1] or that at the time the architect performed his services and filed his "Notice of Construction Lien";[2] or that at the time the Order for Relief was entered on August 19, 1985, and the debtor-in-possession as a trustee occupied the status of a judicial lien creditor,[3] that any of the parties

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1. Miss. Code Ann. §89-5-5 (1972)

2. Miss. Code Ann. §85-7-131 (1972)

3. Miss. Code Ann. §11-7-191 (1972)
   11 U.S.C. §544

had any notice of her claim of a constructive trust. Thus, any claim that she might have is primed by the other three parties.

In regard to the claim of the architect, Richart A. Barron, the question of whether an architect is entitled to a lien on property for his services when no actual construction takes place on the property, appears to be a case of first impression in Mississippi.

There is a split of authorities on the issue. The architect cites the Indiana case of O'Hara v. Architects Hartung and Association, 326 N.E.2d 283 (Ind. App. 1975). Jean East cites Construction Engineering Co. of Louisiana, Inc. v. Village Shopping Center, Inc., 168 So.2d 826 (La.App. 1964) writ referred 247 La. 261, 170 So.2d 512 and several other cases from Louisiana and Wisconsin in support of the position that an architect is only entitled to a lien if there is actual construction.

This Court specifically declines to reach a conclusion of law on this point. Assuming, arguendo, that the architect is correct in his assertion of the law, as a practical matter his claim would be subordinate to that of the Rankin County Bank. All of the money held in escrow will go to the Rankin County Bank and nothing will remain for the benefit of the architect. Under the circumstances, the Court finds that it

is not necessary to decide this point and perhaps it can be addressed first by the Mississippi Supreme Court, since it is a question of state law.

In regard to the claims of the trustee, pursuant to 11 U.S.C. §544 he occupies the status of a judicial lien creditor as of the time the Order of Relief was entered on August 19, 1985. Under Mississippi law, this status is defined by Miss. Code Ann. §11-7-191 (1972). The result is that the claim of the trustee is subordinate to that of the Rankin County Bank and as a practical matter he will receive none of the funds held in escrow.

In his brief the trustee asserts that the Rankin County Bank should be required to marshall assets; that it has two funds to which to look for payment; and, it should first look to another fund for payment rather than to the $24,000.00 held in escrow.

This Court feels that the case of In re Computer Room, Inc., 24 B.R. 732 (Bkrtcy. 1982) contains a good explanation of the doctrine of marshalling of assets (or the "two funds" doctrine). See also Matter of Franchise Systems, Inc., 46 B.R. 158 (Bkrtcy-1985); Matter of Childers, 44 B.R. 23 (Bkrtcy. 1984); and Myers v. United States, 375 U.S. 233, 11 L.Ed.2d 293, 84 S.Ct. 318 (1963).

The short answer to this argument is that the Court does not find anything in the transcript of the

hearing to establish the existence of an unencumbered "second fund" which the Rankin County Bank should be compelled to exhaust before it can reach the funds held in escrow.

CONCLUSION

The Court finds that the indebtedness to the Rankin County Bank in the unpaid principal amount of $83,107.05 as of May 2, 1986, plus accumulated interest, as evidenced by that certain promissory note dated January 25, 1984, in the original principal amount of $85,000.00 is secured by the aforesaid deed of trust dated January 27, 1984, which was filed for record in the Office of the Chancery Clerk of Rankin County, Mississippi, on February 10, 1985. The said deed of trust takes priority over any and all claims of Jean S. East, Richard A. Barron and the Trustee. The Rankin County Bank is entitled to all funds, including interest, being held in escrow from the sale of the parcel of property described in the deed of trust.

IT IS, THEREFORE, ORDERED AND ADJUDGED that the Trustee shall pay over to the Rankin County Bank all funds, including accumulated interest, held by him from the proceeds of the sale of the aforesaid parcel of property.

SO ORDERED, this the 9TH day of July, 1987.

Edward Ellington
U. S. BANKRUPTCY JUDGE