

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

THE JULIEN COMPANY,

Debtor.

No. 90-20283-WHB
Chapter 11

TALLAHATCHIE COUNTY BANK,

Plaintiff,

v.

Adversary Proceeding
No. 90-0344

JACK F. MARLOW, Trustee;
BANKERS TRUST COMPANY, et al.,

Defendants.

v.

L. C. MABUS, JAMES MABUS and
KENNY WEEKS,

Third Party Defendants.

SUPPLEMENTAL MEMORANDUM OPINION AND ORDER
ON MOTIONS FOR SUMMARY JUDGMENT

These proceedings¹ are before the Court on Motion for Partial Summary Judgment filed by the plaintiff, Tallahatchie County Bank, and Cross-Motion for Summary Judgment filed by the defendant, Bankers Trust Company and joined by defendant Trustee, Jack F. Marlow.² At issue is whether Tallahatchie

¹ These proceedings are "core" pursuant to 28 U.S.C. §157(b)(2)(A), (K), and (O).

² Trustee for the Julien Company, Jack F. Marlow, has joined in the Motion for Summary Judgment filed by Bankers Trust Company and relies on the Second Supplemental Memorandum of Law of Bankers Trust Company filed in support thereof, except that the Trustee does not join in Bankers Trust's assertion that it or any other Institutional Lender has a perfected security interest in the cotton collateral in question. See Trustee's Notice of Joining Bankers Trust Company's Motion for Summary Judgment (January 27, 1992).

Company Bank (hereinafter "TCB") holds perfected security interests with priority over Bankers Trust Company³ in the 1989 cotton crops and proceeds of the third party defendants. The following constitutes finding of fact and conclusions of law pursuant to F.R.B.P. 7052 and 7056.

The record reflects that the first Motions for Summary Judgment filed by the respective parties were heard on November 25, 1991. This Court ruled orally and found that genuine issues as to material facts precluded the summary judgments sought. In an Order dated December 19, 1991, this Court denied TCB's Motion for Partial Summary Judgment and Bankers Trust Company's Cross Motion for Summary Judgment. See Order Denying Motions for Summary Judgment (December 19, 1991). The Court also ordered the parties to simultaneously submit written briefs, without oral argument, on the following issues:

- (1) Whether the Food Security Act of 1985 (codified at 7 U.S.C. §1631) preempts the operation of Uniform Commercial Code §9-103(1)(d)(i) [T.C.A. §47-9-103(1)(d)(i) and N.C. Gen. Stat. §25-9-103(1)(d)(i)];⁴ and, if not,
- (2) Whether TCB has lost its priority, perfected security interests in the 1989 cotton crops and proceeds of the third party defendants pursuant to UCC §9-103(1)(d)(i).

Therefore, the Court is asked to resolve whether 7 U.S.C. §1631 preempts UCC §9-103(1)(d)(i) and to determine the effect of that decision on TCB's security interests.

³ In an Order entered March 4, 1992, Bankers Trust Company was substituted in the place of and assumed all the rights and obligations of defendants: Amsterdam-Rotterdam Bank, N.V.; Bank Mees & Hope, N.V.; French American Banking Corporation; Team Bank; and Bayerische Vereinsbank, AG (Union Bank of Bavaria) New York Branch in this adversary proceeding.

⁴ T.C.A. §47-9-103(1)(d)(i) and N.C. Gen. Stat. §25-9-103(1)(d)(i) are the respective state's applicable versions of the identical UCC §9-103(1)(d)(i). For purposes of this opinion, the Uniform Commercial Code will be the only state code to which the Court refers.

UCC §9-103(1)(d)(i)

UCC §9-103(1)(d)(i) states that:

(d) When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Part 3 of this Article to perfect the security interest,

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal; . . .

Therefore, a security interest becomes unperfected under the UCC's "four month rule" when collateral securing an interest perfected under one state's laws is removed to another state and the secured party then fails to reperfect within four months of removal.

In the present case, the parties do not dispute that TCB loaned money to the third party defendants in Mississippi for purposes of financing their 1989 cotton crops. These crops, along with the proceeds thereof, were given as collateral to secure TCB's loan. See Security Agreements between TCB and Kenny Weeks, James Mabus, and L. C. Mabus respectively (attached to Affidavits of TCB in support of plaintiff's Motion for Partial Summary Judgment, filed October 7, 1991). In fall 1989, the cotton was bought by The Julien Company and was shipped from Mississippi to Tennessee and North Carolina where it remained for over four months. At the November 25, 1991 hearing, TCB's attorney stipulated that TCB never filed any financing statements covering its collateral cotton in Tennessee or North Carolina as required by UCC §9-103(1)(d)(i). See Bankers Trust Company's Second Supplemental Memorandum of Law in Support of Its Cross-Motion for Summary Judgment Against TCB, Exhibit A at 28-29 (Jan. 21, 1992).

Thus, according to UCC §9-103(1)(d)(i), TCB lost its perfected security interest due to its failure to file financing statements in Tennessee and North Carolina. The following cases support this conclusion: United States v. Burnette-Carter Co., 575 F. 2d 587, 590-92 (6th Cir. 1978); In re Ken Gardner Ford Sales, Inc., 41 B.R. 105, 108-09 (Bankr. E.D. Tenn. 1984).

However, TCB argues that this section of the UCC is preempted by §1324 of the Food Security Act of 1985 (codified at 7 U.S.C. §1631).⁵

7 U.S.C. §1631

"Congress has specifically attempted to alleviate the burden on and obstruction to interstate commerce in farm products through the Food Security Act, 7 U.S.C. §1631. The provisions of the statute became effective December 23, 1986." FDIC V. Bowles Livestock Comm'n Co., 739 F. Supp. 1364, 1375 (D. Neb. 1990), rev'd on other grounds, 937 F. 2d 1350 (8th Cir. 1991). The Act includes §1324 "which statutorily abrogates the widely enacted 'farm products' exception of §9-307(1) of the Uniform Commercial Code." Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 333 (D. Neb. 1990). Section 1324 (codified at 7 U.S.C. §1631) which is entitled "Protection For Purchasers Of Farm Products . . . was a congressional attempt to eliminate potential exposure of 'purchasers of farm products to double payment liability.'" Id. See 7 U.S.C. §1631(a) (Congressional findings). In its abrogation of the "farm products exception," Congress intended to reallocate the loss from the buyer to the farm products lender when the borrower defaults. See U.S. v. Progressive Farmers Mktg. Agency, 788 F. 2d 1327, 1331 (8th Cir. 1986).

UCC §9-307(1), which includes the "farm products exception," states that:

A buyer in ordinary course of business . . . other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

Id. (emphasis added).

As previously stated, §1631 was passed to abrogate this farm products exception. Specifically, §1631(d) states that:

[e]xcept as provided in subsection (e) and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the

⁵ Food Security Act, Pub L. No. 99-198, 99 Stat. 1535 (1985). See also 9 C.F.R. §205 et seq.

security interest is perfected; and the buyer knows of the existence of such interest.

Id. In addition, the Agriculture Committee reported that:

[t]he bill is intended to preempt state law (specifically the so-called "farm products exception" of the Uniform Commercial Code section 9-307) to the extent necessary to achieve the goals of this legislation. Thus, this Act would preempt state laws that set as conditions for buyer protection of the type provided by the bill requirements that the buyer check public records, obtain no-lien certificates from the farm products sellers, or otherwise seek out the lender and account to that lender for the sale proceeds. . . .

H.R. Rep. No. 271, 99th Cong., 1st Sess., pt. 1, at 110 (1985).

Therefore, the "farm products exception" no longer exists and federal law (7 U.S.C. §1631) is controlling on the subject. The Court in United States v. Walter Dunlap & Sons, Inc., 800 F. 2d 1232 (3d Cir. 1986) (decided prior to the Food Security Act's effective date of December 23, 1986), held that:

. . . federal . . . regulations . . . enacted under a general enabling provision, do not constitute the sort of explicit "congressional directive" that will displace the application of state law as the federal rule of decision We therefore must heed Kimbell's direction to "adopt the readymade body of state law as the federal rule of decision until Congress strikes a different accommodation" The wisdom of pursuing that approach is demonstrated by the enactment of The Food Security Act of 1985 . . . - the type of congressional directive referred to in Kimbell.

Id. at 1239.

PREEMPTION

The question presented to this Court, however, is whether the "four month rule" for perfecting security interests in multi-state transactions (UCC §9-107(1)(d)(i)) is preempted by 7 U.S.C. §1631? The Agriculture Committee's House Report previously quoted also states that ". . . the bill [Food Security Act] would not preempt the basic state-law rules on the creation, perfection, or priority of security interests." H.R. Rep. No. 271, 99th Cong., 1st Sess., pt. 1, at 110 (1985) (emphasis added). See Lisco State Bank, 752 F. Supp. at 338. UCC §9-103(1)(d)(i) is a state law rule dealing with perfection; and therefore, this Court holds that Bankers Trust Company is correct that UCC §9-103(1)(d)(i) is not preempted by 7 U.S.C. §1631. However, this Court disagrees with Bankers Trust regarding the effect of that non-preemption on the case at

hand. Bankers Trust claims that if the "four month rule" is not preempted by §1631, then TCB has lost its perfected security interests. Therefore, as a holder of unperfected security interests, TCB does not have priority over Bankers Trust's interests. See Bankers Trust Company's Second Supplemental Memorandum of Law In Support Of Its Cross-Motion For Summary Judgment against TCB at 14 (January 21, 1992).

As this Court has already found, TCB did lose its perfected security interests under UCC §9-103(1)(d)(i) by not perfecting in Tennessee or North Carolina within four months. However, its unperfection does not affect the operation of §1631. That section is not in conflict with UCC §9-103 because perfection is irrelevant in the operation of §1631. The federal statute clearly states that ". . . a buyer . . . shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest." 7 U.S.C. §1631(d) (emphasis added).

Therefore, according to §1631(d), a buyer will take free and clear of a security interest whether or not it is perfected. To the extent that §1631 conflicts with UCC §9-312 regarding the priority among conflicting security interests in the same collateral, this Court notes §1631(d) specifically states that: "[e]xcept as provided in subsection (e) and notwithstanding any other provision of Federal, State, or local law, a buyer . . . shall take free of a security interest . . ." Id. Thus, if §1631 conflicts with UCC §9-312, it then preempts that state law, but only as to "a buyer who in the ordinary course of business buys a farm product . . ." 7 U.S.C. §1631(d) (emphasis added). The states' comprehensive rules on the creation, perfection or priority of security interests in collateral other than farm products remain the controlling law. See H.R. Rep. No. 271, 99th Cong., 1st Sess., pt. 1, at 110. (1985); Moffat County State Bank v. Producers Livestock Mktg. Assoc., 833 F. 2d 908 (10th Cir. 1987); see also Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 334-35, 335 n. 3 (D. Neb. 1990).

Therefore, The Julien Company, who was a buyer in the ordinary course of business, bought the cotton from the third party defendants free and clear of TCB's security interests created by the sellers, unless one of the exceptions in §1631(e) is met. See 7 U.S.C. §§1631(c)(1) ("buyer in the ordinary course of business" defined), (e).

TCB claims that the conditions in §1631(e)(2) have been satisfied and that The Julien Company did take subject to its security interests. That section states that:

(e) A buyer of farm products takes subject to a security interest created by the seller if -

- (2) in the case of a farm product produced in a State that has established a central filing system -
 - (A) the buyer has failed to register with the Secretary of State of such State prior to the purchase of farm products; and
 - (B) the secured party has filed an effective financing statement or notice that covers the farm products being sold; . . .

Therefore, three requirements must be met in §1631(e)(2). First, the state in which the farm product was produced must have established a "central filing system" certified by the Secretary of the U.S.D.A. See 7 U.S.C. §1631(c)(2) ("central filing system" defined). In this case, the cotton collateral in question was produced in Mississippi, and that state established a central filing system on December 24, 1986.

The second requirement is that the buyer must have failed to register with the Secretary of State of that state before purchasing the farm products. TCB claims it is undisputed that The Julien Company did not register with the Mississippi central filing system. See Memorandum Brief of TCB at 3 (Jan. 22, 1992). However, no proof, in the form of an affidavit from the Mississippi Secretary of State or otherwise, has been offered by TCB on this point. The Court therefore requests that the parties either stipulate to this fact or enter proof to meet this requirement.

Finally, if the first two requirements have been satisfied, the third is that the secured party must have filed an "effective financing statement"⁶ or notice that covers the products sold. The statement must be filed with "the Secretary of State of a State by the secured party." 7 U.S.C. §1631(c)(4)(B). See FDIC v. Bowles

⁶ See 7 U.S.C. §1631(c)(4) ("effective financing statement" defined).

Livestock Comm'n Co., 739 F. Supp. 1364, 1376 (D. Neb. 1990), rev'd on other grounds, 937 F. 2d 1350 (8th Cir. 1991) (secured party failed to preserve security interest under 7 U.S.C. §1631(g)(2)(C) or (D) because financing statements were filed with the County Clerk but not with the Secretary of State). TCB has submitted that it did file "effective financing statements" in Mississippi which covered the 1989 cotton crops and proceeds of third party defendants, Kenny Weeks, James Mabus and L.C. Mabus.⁷ See Financing Statements (attached to Affidavits of TCB in Support of Plaintiff's Motion for Partial Summary Judgment, filed October 7, 1991). Bankers Trust Company, however, claims that TCB failed to list all of the farmers' ASCS farm numbers so as properly to identify all farms on which crops were produced. TCB did not include ASCS farm number 527 on Kenny Weeks' financing statement, and this farm yielded bales of cotton which were sold to The Julien Company. See Joint Memorandum of Law in Opposition to Plaintiff's Motion for Partial Summary Judgment and Bankers Trust Company's Memorandum in Support of Its Cross-Motion for Summary Judgment Against TCB at 6 (Nov. 4, 1991); Affidavit of Kenny Weeks in Support of TCB's Motion for Partial Summary Judgment, ¶2 (Oct. 7, 1991); Financing Statement between TCB and Kenny Weeks (attached to Affidavit of TCB in Support of Plaintiff's Motion for Partial Summary Judgment) (Oct. 7, 1991). Therefore, these financing statements would only be effective as to the specific cotton collateral and its proceeds produced on the farms listed and described in each farmer's financing statement. See 7 U.S.C. §1631(c)(4)(D)(iv).

Thus, this Court holds that if TCB proves that The Julien Company failed to register with the Mississippi Secretary of State pursuant to 7 U.S.C. §1631(e)(2)(A), then The Julien Company took the cotton subject to the security interests of TCB in the specific cotton collateral and proceeds identified in each third party defendant's financing statement. Therefore, any security interests which Bankers Trust Company may

⁷ This Court notes that 7 U.S.C. §1631(c)(4)(B) states that the financing statement must be filed with the Secretary of State of a State by the secured party. In the case of a multi-state transaction, this Court is not ruling on whether filing in the state to which the farm products have been removed is adequate; however, the Court does find that filing with the Secretary of State in the state in which the farm products were produced and in which a central filing system is in place is adequate. 7 U.S.C. §1631(e)(2). See FDIC, 739 F. Supp. at 1376; Brubaker, Farm Products Collateral: Still a Problem?, 1987 U. Ill. L. Rev. 241, 268 (1987).

have against the cotton collateral and proceeds in question will be subject or junior to TCB's interests if all requirements are met.⁸

CONCLUSION

This Court holds that the Food Security Act of 1985 (codified at 7 U.S.C. §1631), which does preempt the "farm products exception" in UCC §9-307(1), does not preempt the operation of UCC §9-103(1)(d)(i) [TCA §47-9-103(1)(d)(i) and N.C. Gen. Stat. §25-9-103(1)(d)(i)]. TCB did lose its perfected security interest in the 1989 cotton crops and proceeds of the third party defendants. However, the perfection status of the security interest is irrelevant to the operation of the federal statute. Section 1631(d) allows a buyer in the ordinary course of business to buy farm products free from security interests, regardless of perfection, unless §1631(e) requirements are met. In this case, if the lender, TCB, satisfies all the conditions under §1631(e)(2), then The Julien Company, and so Bankers Trust Company, took subject to TCB's interests in the cotton collateral and proceeds covered in the financing statements filed with the Mississippi Secretary of State.

IT IS THEREFORE ORDERED that a status conference shall be set for May 14, 1992, at 9:30 a.m., in Courtroom 680, 200 Jefferson Avenue, Memphis, Tennessee. At that time, the Court will accept further stipulations or documentation regarding 7 U.S.C. §1631(e)(2) and will discuss the particular questions of fact and issues left for adjudication at trial, including the issue of whether TCB waived its security interests by its alleged participation in prior settlements reached between the third party defendant farmers and Bankers Trust Company. If this date is not mutually agreeable for counsel, said counsel may consult with each other and with Carol Smith, the Courtroom Deputy, for an alternate date. The Court will not enter a judgment until a final order is entered.

⁸ Each of the Institutional Lenders has filed proofs of claims in this bankruptcy proceeding, and each asserts a perfected security interest in all of the debtor's personal property. The extent, validity and priority of these asserted security interests are not at issue here.

SO ORDERED this 3rd day of April, 1992.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

cc:

William J. Landers
Robert E. Orians
Scott T. Beall
Martin, Tate, Morrow & Marston, P.C.
Eleventh Floor, The Falls Building
22 North Front Street
Memphis, Tennessee 38103

Elder L. Shearon, III
Udelsohn, Blaylock & Marlow
Attorney for Jack F. Marlow, Trustee
44 North Second Street
Suite 700
Memphis, Tennessee 38103

Charles J. Swayze, Jr.
James Y. Dale
Attorneys for Tallahatchie County
Bank and Third Party Defendants
Post Office Box 941
Greenwood, Mississippi 38930

Julie C. Chinn
Assistant U.S. Trustee
200 Jefferson Avenue
Suite 400
Memphis, Tennessee 38103

(Published)