

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

IN RE:

KANDALA RAM CHARY,

Debtor.

BK #91-12120-WHB
Chapter 7

PRESTON WILSON,
Trustee,

Plaintiff,

v.

Adversary Proceeding
No. 92-0651

BANK OF DYER,

Defendant.

MEMORANDUM OPINION AND ORDER
ON CROSS MOTIONS FOR SUMMARY JUDGMENT

This adversary proceeding is before the Court on cross motions for summary judgment on the complaint to determine the extent, validity, and priority of liens filed by Mr. Preston Wilson, the bankruptcy trustee ("Trustee"), against the Bank of Dyer ("Bank").¹ At issue is whether a recorded Deed of Trust executed by the debtor in favor of the Bank constitutes a perfected security interest in certain property superior to the Trustee's interest. This issue presents a core proceeding pursuant to 28 U.S.C. §157(b)(2)(K). The following constitutes findings of fact and conclusions of law in accordance with F.R.B.P. 7052.

The facts essential to resolution of the dispute have been stipulated by counsel for these parties as follows:

¹ Whalley Properties, Brenda Whalley and First American National Bank were initially named as defendants also. However, the parties have since agreed that the dispute here is between the Trustee and the Bank of Dyer only.

1. Whalley Properties ("the Partnership") is a General Partnership of the Debtor, Kandala Ram Chary, M.D. ("Chary") and Brenda Whalley ("Whalley"). It was organized on or about June 27, 1986, to acquire approximately 15 acres in Madison County, Tennessee ("the Partnership Property"), which is more particularly described in a Warranty Deed, a copy of which is attached to the stipulations as Exhibit A. Whalley and Chary are equal partners in the Partnership and at the time the Partnership was organized there was no written partnership agreement.

2. The Partnership Property secures a purchase money mortgage or deed of trust lien evidenced by a Note in the amount of \$120,000 in favor of James L. Smith and Albert Dodson. The purchase money deed of trust is not at issue in this litigation.

3. On or about December 31, 1986, First American National Bank ("FANB") loaned to Whalley Construction Company the original principal sum of two million dollars (\$2,000,000.00), which was guaranteed by A.E. Whalley, III and wife, Brenda Whalley. The loan and guaranty were not for purposes associated with Whalley Properties. To secure such guaranty, Brenda Whalley purported to convey to FANB a one-half (1/2) undivided interest in the Partnership Property, and also granted a security interest to FANB in her partnership interest in Whalley Properties. The purported conveyance of the real estate and the granting of the security interest was done by means of a Deed of Trust dated December 31, 1986, and recorded in Trust Deed Book 729, Page 69, in the Register's Office of Madison County, Tennessee. A copy of FANB's Deed of Trust is attached to the stipulations as Exhibit B.

4. On August 31, 1990, Bank of Dyer loaned Chary \$246,000 to be used by Chary for private business pursuits unrelated to Partnership activity. At the time the loan was made, the Bank of Dyer knew that the loan proceeds were to be used by Chary in his individual capacity. The Bank of Dyer purported to secure its loan by a deed of trust lien on the Partnership Property. There was no UCC filing with regard to the Bank of Dyer's security interest in the Partnership Property. A copy of the Deed of Trust is attached to the stipulations as Exhibit A and incorporated therein by reference. This Deed of Trust is of record in Trust Deed Book 826, Page 686, in the Register's Office of Madison County, Tennessee.

5. A copy of the Note executed by Chary in connection with the loan of the Bank of Dyer is attached to the stipulations as Exhibit D.

6. No other documentation was executed in connection with the loan of Bank of Dyer to Chary.

7. There is no challenge by the Trustee that the Deed of Trust to FANB was validly executed and recorded, or to the conveyance by Brenda Whalley in the Deed of Trust of a security interest (if such conveyance was effective) in Brenda Whalley's one-half (1/2) partnership interest in Whalley Properties.

DISCUSSION

It is well settled that the commencement of a bankruptcy case creates an estate comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. §541(a). In addition, the case trustee is vested with the rights and power of a judgment lien creditor at commencement of the case. 11 U.S.C. §544(a). However, it is equally well settled that the extent of the debtor's interest, and thus, the trustee's and estate's interest in property at commencement of the case is to be ascertained pursuant to state law. Barnhill v. Johnson, _____ U.S. _____, 112 S. Ct. 1386, 1389 (1992).

Applicable in this proceeding is Tennessee law which provides that the property rights of a partner are:

- (1) His rights in specific partnership property;
- (2) His interest in the partnership; and
- (3) His right to participate in the management.

Tenn. Code Ann. §61-1-123.

According to relevant case law, a partner's right in "specific partnership property"

is the partnership tenancy possessory right of equal use or possession by partners for partnership purposes. This possessory right is incident to the partnership and does not exist absent the partnership . . . Therefore, a co-partner owns no personal specific interest in any specific property or asset of the partnership. The partnership owns the property or asset.

Putnam v. Shoaf, 620 S.W. 2d 510, 513-514 (Tenn. Ct. App. 1981) (emphasis in original). Moreover, "the partner's interest in the partnership . . . is defined as 'his share of the profits and surplus and the same is

personal property." Id. (citing Tenn. Code Ann. §61-1-125). Such property may not be possessed for any non-partnership purposes absent consent of all partners. Tenn. Code Ann. §61-1-124.

As such, it is evident that although a co-partner owns no specific partnership asset or property individually, state law provides for the use of partnership property by individual partners to further non-partnership interests when and if all partners consent to such use. Tenn. Code Ann. §61-1-124(b). This same provision is echoed in the partnership agreement executed in 1988 but back-dated to June 27, 1986 by the debtor and his partner, Brenda Whalley. Ex. 8 to deposition of Dr. K.R. Chary. Neither the statutes, case law nor the partnership agreement mandate that the consent provided for should be in any particular form. Accordingly, there is apparently no rule prohibiting consent given orally or consent inferred from the co-partners' conduct.

As set forth above, the facts here reflect that both the debtor and his partner attempted to encumber the partnership property for their individual business pursuits. As argued by the Bank, it may be inferred from such conduct that these partners intended to retain authority to so encumber the property for their individual interests and, thus, impliedly consented to such encumbrances. The Court is not satisfied that authority to convey the entire partnership property was retained by each partner. In her deed of trust to FANB Brenda Whalley purported to convey only her "partnership interest." See Ex. B to Stipulation.

Even with consent, however, it is clear that where property, real or personal, is owned by a partnership, as to the partner's interest, it is deemed personalty as a matter of law for purposes of transfer or encumbrance. Tenn. Code Ann. §61-1-125. Therefore, notwithstanding the debtor's testimony that he understood that he would own 50% of the property at issue rather than 50% of a partnership and the Bank's argument that the partners intended to retain authority to encumber the property, the fact that the debtor and Mrs. Whalley formed a partnership to acquire the property has been stipulated. Deposition of Dr. K.R. Chary, pp. 44-45, 52; see also Ex. 8 to the Deposition of Dr. K.R. Chary, i.e., "Partnership Agreement;" and Stipulation No. 1. In addition, the debtor further testified that Mrs. Whalley's and his purchase of the property was structured as it was because he did not at that time want his name appearing of public record as

an owner of the property. Deposition of Dr. K.R. Chary, pp. 51-52. The evidence further reflects that the written partnership agreement between these parties was executed by the debtor approximately two years before he obtained the loan at issue. Consequently, the evidence is overwhelming that the property is owned by the partnership rather than by these individuals pro-rata, and the partners' interests are accordingly subject to state law classification as personalty.

The Bank argues that Dr. Chary transferred the partnership property to it as security for its loan. However, that conclusion is contradicted by the fact that the loan was for personal and non-partnership purposes. Moreover, the Bank's position ignores that under §544 the Trustee stands in the shoes of a judgment and an unsecured creditor. As between the Bank and the Trustee the Bank is simply an unperfected creditor, and §551 preserves the Bank's unperfected position for the benefit of the Trustee. The Bank can not escape from the legal conclusion that perfection of a security interest in personalty in Tennessee is governed by the Uniform Commercial Code and evidenced by compliance with the documentation and filing requirements specified therein. See Tenn. Code Ann. §47-9-102, et. seq. It is uncontroverted here that the Bank's security interest is evidenced only by the recorded deed of trust on the partnership real estate executed in its favor by the debtor for non-partnership purposes. This deed of trust is insufficient under Tennessee law to perfect the Bank's security interest in the debtor's partnership interest. As such, as a matter of law, the Bank holds an unperfected security interest that is inferior to the Trustee's 11 U.S.C. §544(a) judgment lien interest in the debtor's partnership interest.

From the foregoing, it is hereby ORDERED that:

1. The motion for summary judgment filed by the Bank of Dyer is DENIED;
2. The motion for summary judgment filed by Preston Wilson, Trustee, is GRANTED.

SO ORDERED this 15th day of June, 1993.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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