

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

ENTERED

FEB 11 2000

U.S. Bankruptcy Court
Greensboro, NC

ME

IN RE:)
)
Delicate Touch Delivery, Inc.,) Case No. 99-11124C-7G
)
Debtor.)
)

ORDER

This case came before the court on February 1, 2000, for hearing upon a motion by High Point Bank & Trust Company to compel the Trustee to abandon certain proceeds obtained by the Trustee from a bank account in the name of the Debtor. Allen B. Powell appeared on behalf of High Point Bank & Trust Company ("the Bank") and William O. Moseley, Jr. appeared on behalf of the Trustee. Having considered the evidence offered by the parties, the court finds and concludes as follows:

1. On or about January 29, 1998, the Bank loaned the Debtor \$100,000.00 and the Debtor executed a promissory note evidencing the debt, together with a security agreement granting the Bank a security interest in various collateral, including all accounts and proceeds of accounts of the Debtor.

2. The Debtor filed a voluntary petition for relief under Chapter 7 on May 17, 1999, and William O. Moseley, Jr. was appointed as Trustee in Debtor's Chapter 7 case.

3. The Trustee thereafter collected \$8,398.96 from certain accounts receivable of the Debtor which were outstanding when the Chapter 7 case was filed. In addition, the Trustee collected from First 1 Bank the sum of \$3,998.25 which was on deposit in a checking account in Debtor's name at First 1 Bank when the Chapter 7 case was filed.

4. On December 1, 1999, the Bank filed a motion pursuant to § 554(b) for an order requiring the Trustee to abandon the \$8,398.96 which the Trustee collected from account debtors of the Debtor and the \$3,398.25 which the Trustee obtained from the account at First 1 Bank on the grounds that these amounts represented proceeds from accounts receivable which were subject to the security interest of the Bank.

5. The Trustee concedes that the Bank had a perfected security interest in the \$8,398.96 of proceeds which were collected from account debtors and has agreed that these funds should be turned over to the Bank. However, the Trustee disputes the Bank's claim that the funds in the First 1 Bank account represent proceeds which are subject to the security interest of the Bank.

6. Debtor's account at First 1 Bank was opened approximately five days before the Chapter 7 petition was filed. Four deposits into the account were made by the Debtor that consisted of some

cash and some checks made payable to the Debtor. Various amounts were withdrawn from the account at First 1 Bank such that only the sum of \$3,998.25 remained in the account when the Trustee made demand on First 1 Bank for the proceeds in the account.

7. Prior to filing for bankruptcy relief, the Debtor was in the business of delivering furniture. Debtor's business included delivering furniture purchased by consumers from retail furniture outlets under an arrangement in which Debtor's charges for delivering the furniture were billed to the consumer. These delivery charges were collected by the driver who delivered the furniture through collections that included checks, money orders and, in some cases, cash. These collections were then delivered to Debtor's office by the drivers upon their return.

8. It is undisputed that the Bank acquired a security interest in the "accounts" of the Debtor. The Bank maintains that the receivables which were generated when furniture was delivered constitute accounts and that the checks and cash collected by the driver were proceeds from such accounts and thus covered by the Bank's security agreement.

9. The definition of "accounts" under the Uniform Commercial Code is contained in G.S. § 25-9-106 which provides that an account is "any right to payment for goods sold or leased or for services

rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." Because Debtor's receivables were the result of Debtor rendering services, i.e., delivery of furniture, and represented a right to payment for those services, the receivables generated by Debtor constitute "accounts" unless such receivables were evidenced by an "instrument" or "chattel paper." Both of these terms are defined in the Uniform Commercial Code as adopted in North Carolina.

10. G.S. § 25-9-105(1)(i) defines "instrument" as meaning "a negotiable instrument . . . or a certificated security . . . or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary endorsement or assignment." "Essential to any document which can be regarded as falling within the Code's definition of 'instrument,' as quoted above, is that it be given some legal efficacy by means of signatures or their equivalents which would bind those who are obligated." In re Transp. Clearings-Midwest, Inc., 26 B.R. 282, 286 (Bankr. W.D. Mo. 1982). There is no suggestion in the present case that any such documents were generated with respect to Debtor's delivery of freight. Presumably, as a motor carrier, the Debtor issued freight bills

which identified the shipper, the consignee, their addresses, the points of origin and destination, a description of the furniture transported and the total charge for delivering the furniture. However, a freight bill does not create, secure, modify or terminate the right to payment of freight charges. Rather, the right to payment for freight charges exists independently of the bill. It is not the issuance of the document, but the shipping and receiving of the goods, which provides the evidentiary basis for the payment. For example, in a suit brought for payment of a freight bill, it would not be enough merely to prove the existence of the freight bill, without more. The fact of performance, i.e., delivery of the goods, would additionally have to be proved. A freight bill therefore does not constitute an instrument. See In re Transp. Clearings-Midwest, Inc., 26 B.R. 282, 286 (Bankr. W.D. Mo. 1982). The court concludes, therefore, that the obligations of consumers to whom Debtor delivered furniture to pay freight charges were not evidenced by any document satisfying the requirements of G.S. § 25-9-105(1). Instead, the situation was one in which the recipients of the furniture from the Debtor merely became obligated to pay the freight charges upon receiving the furniture. These transactions gave rise to an account receivable which could be collected by showing delivery of the furniture, rather than suing

on any "instrument" which was enforceable against the customer.

11. The accounts receivables generated by Debtor's delivery of furniture likewise cannot be regarded as "chattel paper" for purposes of G.S. § 25-9-106. Under G.S. § 25-9-105(1)(b), "chattel paper" is defined as requiring a writing which both evidences a monetary obligation and a security interest in or a lease of specific goods." Under this definition, accounts receivable which do not involve a writing providing for the creation of a security interest in specific goods cannot constitute chattel paper. See In re Padgett, 49 B.R. 212, 214 (Bankr. W.D. Ky. 1985) (stating that accounts are not chattel paper where there is no language in the document which indicated that the parties intended to create a security interest). In the present case, there was no indication that any type of writing was issued which purported to create a security interest in any property. Therefore, the accounts receivable of the Debtor were not "chattel paper" for purposes of G.S. § 25-9-106.

12. Since the Bank had a perfected security interest in the "accounts" of the Debtor and since the accounts of the Debtor were not evidenced by an "instrument" or "chattel paper", the security interest of the Bank extended to the accounts receivable which resulted from Debtor's delivery of furniture to customers.

Additionally, under G.S. § 25-9-203(3), as a result of its security interest in Debtor's accounts, the Bank also had the right to proceeds of those accounts to the extent provided under G.S. § 25-9-306.

13. Under G.S. § 25-9-306(1), proceeds includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds, and under subsection (2) of G.S. § 25-9-306, a security interest continues in any identifiable proceeds realized from a disposition of collateral. However, a security interest in proceeds becomes unperfected 10 days after receipt of the proceeds by the debtor unless one of the requirements contained in G.S. § 25-9-306(3) (a) through (c) is met. G.S. § 25-9-306(3) (b) provides for continuous perfection in cash proceeds if "a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds." In the present case, it is undisputed that the Bank filed financing statements covering the original collateral, i.e., the accounts. However, in order for the Bank to have a security interest in the \$3,998.25 in the account at First 1 Bank, the funds in the accounts must be identifiable cash proceeds. As indicated earlier, the funds that went into the account consisted of some checks from customers and some cash. The Trustee does not dispute that the

checks may constitute identifiable cash proceeds. The dispute between the Trustee and the Bank involves the portion of the deposits which consisted of cash, which the Trustee argues cannot constitute identifiable cash proceeds. However, the testimony of the witnesses offered by the Bank established by a preponderance of the evidence that the cash as well as the checks which were deposited into the account at First 1 Bank were proceeds of accounts. In that regard, the testimony of these witnesses established that the only cash which was deposited into the account was cash which the drivers collected from consumers to whom freight was delivered.

14. While the term "identifiable cash proceeds" is not defined in the Uniform Commercial Code, no better example comes to mind than an account containing nothing but deposits of proceeds which resulted from the collection of accounts subject to the creditor's security interest. Because the Bank's security interest in the accounts of the Debtor was perfected by the filing of financing statements and because the funds in the First 1 Bank account were identifiable cash proceeds from the encumbered accounts, the court concludes that the Bank's security interest in the funds in the account was continuously perfected pursuant to G.S. § 25-9-306(3)(b).

15. To the extent that it could be argued that there should be a different result with respect to the final deposit into the account on May 18, 1999, which was one day after the filing of the petition, such argument must be rejected. Section 552(b)(1) of the Bankruptcy Code provides a secured creditor with a security interest in postpetition proceeds when a prepetition security agreement exists that provides for a security interest in both the prepetition original collateral and proceeds of that collateral under nonbankruptcy law. The Fourth Circuit has construed the term "proceeds" as used in § 552(b) to be identical to the definition used in the Uniform Commercial Code. See In re Bumper Sales, Inc., 907 F.2d 1430, 1437-38 (4th Cir. 1990) ("[W]e hold that the UCC's definition and treatment of proceeds applies to section 552 of the Bankruptcy Code.").

16. Having concluded that the Bank had a perfected security interest in all of the funds remaining in the First 1 Bank account because the account consisted entirely of proceeds, the remaining issue is how such security interest should be treated in light of Debtor having filed bankruptcy. G.S. § 25-9-306(4) is controlling with respect to this issue. See Stoumbous v. Kilimnik, 988 F.2d 949, 957 (9th Cir. 1993); In re Quaker Distribs., Inc., 189 B.R. 63, 71 (Bankr. E.D. Pa. 1995). Subsections (a) through (c) of

G.S. § 25-9-306(4) deal with situations in which the proceeds are segregated and identifiable. All three subsections revolve around whether the proceeds were deposited in a "deposit account" at the time of the bankruptcy. G.S. § 25-9-105(1)(e) defines "deposit account" as being "a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit." The account at First 1 Bank was a standard demand checking account and, therefore, constitutes a "deposit account" under the Uniform Commercial Code. In the present case, the provision which is controlling with respect to the status of the funds in that "deposit account" is G.S. § 25-9-306(4)(a) which provides:

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) In identifiable noncash proceeds and in separate deposit accounts containing only proceeds

This provision recognizes a security interest in two types of proceeds, to wit, in identifiable noncash proceeds and in proceeds on deposit in separate deposit accounts which contain only

proceeds. See In re Quaker Distribs. Inc., 189 B.R. at 72; In re Bargotti Bros. Bakery, Inc., 80 B.R. 745, 747 (Bankr. W.D. Pa. 1987); In re Allegheny Imaging, Inst., 69 B.R. 932, 937 (Bankr. W.D. Pa. 1987). In the present case, the \$3,998.25 which was on deposit in the account at First 1 Bank constitute proceeds in a separate deposit account which contained only proceeds. It follows, therefore, that the Bank had a perfected security interest in these proceeds notwithstanding the filing of Debtor's bankruptcy case. Because of the Bank's perfected security interest, the Trustee is not entitled to retain such funds and, therefore, the motion to require that the funds be abandoned to the Bank will be granted.

IT IS SO ORDERED.

This 11th day of February, 2000.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge