UNPUBLISHED OPINION

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

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See #221

In re	)	Bankruptcy Case No. 86C-0096
I.F.S. INCORPORATED, a corporation,	)	
Debtor.	)	
I.F.S. INCORPORATED, a corporation,	)	Civil Proceeding No. 86PC-0334
Plaintiff,	)	
v.	)	
NATIONAL CREDIT UNION ADMINISTRATION BOARD as Liquidating Agent for Center Place Savings Credit Union and ELLSWORTH FINANCIAL CORPORATION,	)	MEMORANDUM DECISION
Defendants.	)	

Appearances: John B. Maycock and Blake D. Miller, Hansen & Anderson, Salt Lake City, Utah, for the debtor; Noel S. Hyde, Nielsen & Senior, Salt Lake City, Utah, and Gary H. Feder and Kevin L. King, Shifrin & Treiman, Clayton, Missouri, for National Credit Union Administration Board as Liquidating Agent for Center Place Savings Credit Union; Peter W. Billings, Jr., Fabian & Clendenin, Salt Lake City, Utah, and Harold L. Kaplan, Mayer, Brown & Platt, Chicago, Illinois, for Ellsworth Financial Corporation.

This matter comes before the Court on the parties' respective motions for summary judgment. The Court believes there are no material factual disputes necessary to the resolution of the issues before it. Therefore, the Court issues the following Memorandum Decision, granting defendants' motions for summary judgment.

FACTUAL SETTING

The basic facts are not in dispute. I.F.S., Inc. ("I.F.S.") is a holding company of certain insurance marketing and underwriting companies. On or about July 8, 1983, I.F.S. executed a promissory note in favor of Center Place Savings Credit Union ("Center Place") in the principal amount of $450,000.00. I.F.S. also executed a guaranty to Center Place guaranteeing the payment of the note, together with seven other promissory notes executed by related entities and individuals which were also held by Center Place. The guaranty was in an aggregate principal amount of $3,500,000.00. To secure these obligations, I.F.S. executed a Pledge and Security Agreement, dated July 8, 1983, granting Center Place a security interest in 104,122 shares of common stock in Service Life Insurance Company of Omaha ("SLI") owned by I.F.S. The Pledge and Security Agreement contained the following default provision:

> If a default has occurred and not been cured or waived, immediately and without further notice, whether or not the SLI Shares,

> Diamond Shares, Balanced Security Shares or IFS Shares shall have been registered in the name of the Lender or its nominee, the Lender or its nominee shall have, with respect to such shares, the right to exercise all voting rights as to all such shares and all other corporate rights and all conversion, exchange, subscription or other rights, privileges or options pertaining thereto as if it were the absolute owner thereof, including, without limitation, the right to exchange any or all of such shares upon the merger, consolidation, reorganization, recapitalization or other readjustment of the issuer thereof, or upon the exercise by such issuer of any right, privilege, or option pertaining to any of such shares, and, in connection therewith, to deliver any of such shares to any committee, depository, transfer agent, registrar or other designated agency upon such terms and conditions as it may determine, all without liability except to account for property actually received by it; but the Lender shall have no duty to exercise any of the aforesaid rights, privileges or options and shall not be responsible for any failure to do so or delay in so doing.

On July 2, 1985, Center Place notified I.F.S. that its note was in default by virtue of its failure to make the July 1, 1985 interest payment. It thereby demanded that I.F.S. make immediate payment of the unpaid principal, together with all accrued interest. On July 8, 1985, Center Place was placed into liquidation and the National Credit Union Administration Board (NCUAB) was appointed liquidating agent. By letter dated July 12, 1985, the NCUAB notified I.F.S. that it intended to commence efforts to sell the SLI shares. On November 14, 1985, the NCUAB had the SLI shares registered in its own name.

Between August 1985 and January 1986, the NCUAB negotiated with various prospective purchasers for the sale of the SLI shares. On January 3, 1986, upon learning that the NCUAB was negotiating with Ellsworth Financial Corporation ("Ellsworth") for the latter's purchase of the SLI shares, an officer of I.F.S. telephoned Jim Ellsworth to inform him of I.F.S' interest in the shares and of their intent to file a Chapter 11 petition to protect that interest.[1] On January 13, 1986, Ellsworth and the NCUAB entered into a Letter of Intent for the purchase of the SLI shares. By letter dated February 28, 1986, I.F.S sent to Ellsworth a copy of an Amended Counterclaim which I.F.S. allegedly intended to file in an action in the United States District Court for the Western District of Missouri, which the NCUAB had filed against it. The Amended Counterclaim set forth the claims of I.F.S. against the NCUAB for its alleged failure to comply with the Pledge Agreement and the Uniform Commercial Code.

On January 29, 1985, Ellsworth and the NCUAB entered into a Stock Purchase Agreement for the sale of the SLI shares. Ellsworth's obligation to purchase the shares was expressly

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Although the parties substantially dispute the content and nature of that telephone conversation, the Court assumes for the purpose of this motion that I.F.S. informed Ellsworth that it was the owner of the shares, that I.F.S had various claims against the NCUAB for conversion, that I.F.S. was preparing a Chapter 11 petition, that the Board of Directors of I.F.S. had authorized the filing of the petition and that the petition would be filed for the purpose of protecting the interest of I.F.S. in the SLI shares.

conditioned upon approval of the sale by the Nebraska Department of Insurance, as well as the absence of "any order, decree or decision restraining or enjoining or otherwise opposing the consummation" of the sale. However, the Agreement provided that these conditions "may be waived by [Ellsworth] pursuant to a written instrument executed by an officer of [Ellsworth] and delivered to NCUAB and Service Life." The Stock Purchase Agreement also contained warranties by the NCUAB that it was "the lawful, record and beneficial owner of all the shares . . . ." On March 3, 1986, the Nebraska Department of Insurance approved the sale of the SLI shares to Ellsworth.

On March 7, 1986, I.F.S. filed its Chapter 11 petition. The NCUAB's sale of the SLI shares to Ellsworth was closed on March 10, 1986. Ellsworth received its notice of the bankruptcy filing on March 11, 1986.

I.F.S. has filed this adversary proceeding against the NCUAB and Ellsworth, pursuant to § 549 of the Bankruptcy Code, seeking to avoid the sale as an unauthorized transfer of property of the estate in violation of § 362(a) of the Code. I.F.S. also seeks a declaratory judgment establishing it as the owner of the shares subject only to the rights of the NCUAB as a "secured party in possession," and an order returning possession of the shares to I.F.S. Finally, I.F.S. asks for an injunction enjoining the NCUAB and Ellsworth from exercising any voting control over the

SLI shares, or exerting control or direction over the business affairs of SLI. The matter is now before the Court on respective motions for summary judgment by each of the parties in interest.

I.F.S. Claims

The heart of I.F.S.' motion for summary judgment is that it is the rightful owner of the SLI shares. Its position is that the shares were property of the estate at the time of filing since the NCUAB only held the stock as the successor in interest of a secured party. Therefore, since the stock was sold post-petition, the transaction was void as a violation of the automatic stay under § 362(a) and may be recovered under § 549. In support of its position, I.F.S. notes that the default provision in the Pledge and Security Agreement provides that the secured party may exercise certain rights "as if" it were the owner. Furthermore, I.F.S. argues that the NCUAB could not dispose of the SLI shares as an owner since it failed to give proper notice under U.C.C. § 9-505(2) (which allows a secured party to retain collateral in satisfaction of the obligation upon proper written notice). Since notice was not given pursuant to U.C.C. § 9-505(2), I.F.S. maintains that the NCUAB could only have disposed of the collateral under § 9-504 (which allows a secured creditor to sell its collateral after proper notice at private or public sale and apply the proceeds to the debt).

I.F.S. argues that the transfer to Ellsworth may be set aside under §§ 549 and 550(a) since Ellsworth was an initial transferee of an unauthorized transfer of estate property. Moreover, I.F.S. claims that even if Ellsworth was an immediate transferee of an initial transferee or a mediate transferee, it did not take title in good faith and without knowledge by virtue of the January 3 telephone conversation and/or the February 28 letter with its enclosed Amended Counterclaim. Finally, I.F.S. asserts that the Stock Purchase Agreement did not purport to be a transfer under U.C.C. § 9-504 since the NCUAB warranted that it was the absolute owner of the shares and therefore only transferred whatever rights the NCUAB had in the collateral and did not transfer the debtor's property interest in the shares.

The last claim of I.F.S. is that there was an unfulfilled condition precedent to NCUAB's rights under the default provision since it failed to first "draw upon" certain letters of credit as required by the Pledge and Security Agreement.

NCUAB's Claims

The gravamen of the NCUAB's position is that it was the absolute owner of the shares at the time of the bankruptcy filing since it had perfected its ownership rights under the default clause of the Pledge Agreement by having the stock transferred to its name. The NCUAB bases its argument on its reading of the default clause which it believes clearly gives it the right to

transfer the shares to its name upon default, and thereby become the absolute owner of the stock. Moreover, the NCUAB contends that, pursuant to the operation of U.C.C. § 9-506 (which provides that the debtor may redeem collateral at any time before the secured party enters into a contract for its disposition), even if it had only been selling the SLI shares as a secured party, the execution of the Stock Purchase Agreement cut off any right of redemption which the debtor may have had. Therefore, since the SLI shares were not property of the estate, the NCUAB maintains that there could not have been a violation of the stay, nor an unauthorized transfer under § 549.

The NCUAB asserts that it was not obligated to collect on the letters of credit before it could sell the stock. Since it had tendered the necessary documents to the appropriate banks, it had done all it was required to do under the Pledge Agreement. Moreover, the NCUAB argues that its remedies provided in the Pledge Agreement were cumulative, in any event.

Ellsworth's Claims

Ellsworth's position is that it was an immediate transferee of an initial transferee or mediate transferee who purchased the shares in good faith and is protected under § 550(b). Ellsworth contends that I.F.S. had no legal title to the SLI shares when it filed bankruptcy. It argues that I.F.S.' argument under § 362 would make §§ 549 and 550(b) meaningless.

DISCUSSION

Section 549

Section 549 provides that "the trustee may avoid a transfer of property of the estate made after commencement of the case . . . that is not authorized under this title or by the court." (Emphasis added.) In order to prevail under this section, the debtor must demonstrate there was "property of the estate" which was transferred postpetition.

The issue which appears to be paramount in the minds of the parties, as gleaned from the arguments and briefs of counsel, is whether the NCUAB sold or attempted to sell the SLI shares as a secured party or as the absolute owner and whether, in fact, the NCUAB or the debtor was the actual owner of the shares on the date of filing. However, the Court believes that it need not decide those issues in order to resolve the matter presented to it.

The Missouri version of the Uniform Commercial Code, as altered by the contractual agreements of the parties, governs the transactions at issue in this case. Pursuant to Article 9 of the U.C.C., the vesting of title is irrelevant. Rather the appropriate focus of inquiry is on the rights of the parties in the collateral. The Official Comment to § 9-101 states:

> This Article does not determine whether "title" to collateral is in the secured party

> or in the debtor and adopts neither a "title theory" nor a "lien theory" of security interests. Rights, obligations and remedies under the Article do not depend on the location of title.

Likewise, § 400.9-202 of the Missouri Revised Statutes provides:

> Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

Unlike the application of certain taxation statutes under which the situs of legal title is solely determinative, the concept of estate property under the Bankruptcy Code depends on the debtor's rights and interests in property and not on legal title per se. 11 U.S.C. § 541(a), (d).

Of course, the Court recognizes, as the defendants herein argue, that the parties to a transaction may contractually agree to rights and remedies in addition to those provided under Article 9. U.C.C. § 9-501(2). If the default provision in the Pledge and Security Agreement were effectively construed to authorize the NCUAB to register the stock in its name upon default and to thereby become the absolute owner of the SLI shares, that agreement would be enforceable under the U.C.C. and the debtor would have had no claim to ownership after such a registration. However, for the purpose of the defendants' motions for summary judgment, the Court will assume the NCUAB was exercising its rights as a secured creditor at all times critical herein and that the debtor retained whatever rights it may have

had in the collateral, pursuant to the appropriate provisions of the U.C.C. and the Bankruptcy Code.

The critical issues therefore are whether the debtor had any rights in the collateral on the date it filed its Chapter 11 petition, whether those rights rose to the level of "estate property," and whether those rights were transferred post-petition.

Since the nature of the security interest involved was a pledge of stock, it is clear that the debtor had no possessory interest in the SLI shares. Center Place perfected its security interest by possession. In addition, from November 14, 1985, the debtor was no longer even the record owner of the stock.

It is clear from the facts before the Court that the debtor's only rights in the collateral are those protections afforded it by the applicable provisions in Part V of Article 9 of the U.C.C. Section 9-504 provides in pertinent part:

> A secured party after default may sell, lease or otherwise dispose of any or all of the collateral . . .
>
> Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. . . . [R]easonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor . . .
>
> When collateral is disposed of by a secured party after default, the disposition

> transfers to a purchaser for value all of the debtor's rights therein . . .

Section 9-506 provides:

> At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 . . . the debtor . . . may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

The NCUAB within one week of its appointment gave notice to the debtor of its intent to sell the stock "which efforts will be initiated on the 19th day of August, 1985, and subsequent thereto." The Court finds that notice substantially complies with the notice requirements of § 9-504(3) since it gave reasonable notice "of the time after which [a] private sale or other intended disposition [would] be made."

I.F.S. argues that the NCUAB never purported to transfer the debtor's interest in the stock to Ellsworth. Rather, it asserts, the NCUAB warranted that it--the NCUAB--was the owner of the shares, and therefore all the NCUAB sold to Ellsworth was its interest. Hence, the debtor concludes, the Stock Purchase Agreement could not have been a contract for disposition under § 9-504. We do not agree. Ellsworth undoubtedly intended to buy

the stock free and clear; it did not intend merely to purchase a particular party's interest. It negotiated warranties to assure that it received a fee interest in the stock. Moreover § 9-504 does not require that the secured party represent that it is selling the debtor's interest in the collateral. Rather, that provision provides that the secured party may sell or dispose of the collateral, and that such a disposition effectively "transfers to a purchaser for value all of the debtor's rights therein . . ." Missouri Revised Statutes § 400.9-504(4). The Court accordingly finds that the Stock Purchase Agreement was a contract for disposition of collateral under § 9-504.

Subsequent to the time of the notice under § 9-504, debtor's rights in the stock consisted of its right of redemption under § 9-506. That provision provides that the debtor could redeem at any time before the NCUAB "disposed" of the SLI shares "or entered into a contract for its disposition under Section 9-504." The NCUAB did the latter. Having given proper notice, the NCUAB entered into a contract with Ellsworth prepetition for the purchase of the shares. It is clear from the language of § 9-506 quoted above that it is not necessary that the secured party have finally disposed of the collateral to cut off the debtor's redemption rights. It is sufficient that the secured party have "entered into a contract for its disposition." That the NCUAB clearly did. By the operation of this provision, the debtor's

fixed right of redemption pursuant to U.C.C. § 9-506 was cut off prepetition.

The debtor argues that the Stock Purchase Agreement was conditional and therefore was not a sufficient contract to extinguish its rights under § 9-506. It specifically notes that Ellsworth could have been excused from performance postpetition, because the automatic stay was "an order [or] decree . . . restraining or enjoining . . . the consummation" of the sale, which the Agreement made an expressed condition to performance. We cannot agree. The referenced paragraph in the Stock Purchase Agreement did not create any rights in the debtor. The NCUAB was unconditionally bound to perform. Only Ellsworth had the right to excuse its performance upon the occurrence of one of those conditions. It is true that upon nonperformance by Ellsworth, the debtor would again have the right to redeem. However, that right of redemption was merely a contingent right, which would become fixed only upon nonperformance of a third party.[2] The Court, therefore, finds that the debtor's only interest in the SLI shares at the time of filing consisted of a remote and contingent right of redemption which would become fixed only upon the nonperformance of a third party.

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The same is most likely true of any § 9-506 contract for disposition, whether conditional or not--if the third party refused to perform, the debtor should again be vested with the right of redemption.

The question left for resolution and to which the Court now turns is whether the debtor's contingent right of redemption under U.C.C. § 9-506 is a sufficient interest in property to constitute "property of the estate" under § 541; and if it is estate property, whether the postpetition closing of the sale which effectively terminated those contingent rights constituted a "transfer" of property of the estate. Pursuant to § 541(a), property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Section 101(48) defines "transfer" as

> every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property.

Recognizing the expansive definitions of "property of the estate" and "transfer," the Court finds that the debtor's contingent right of redemption constituted property of the estate and that its termination postpetition amounted to a "mode . . . of parting with property." As such, this transfer of property of the estate violated the literal language of § 549(a) and the debtor would be entitled to avoid the transfer.

However, notwithstanding the foregoing, the debtor is not entitled to the remedies which it seeks. The only property interest which the debtor had "as of the commencement of the case" was its contingent right of redemption which would become fixed only upon nonperformance by Ellsworth. The legislative

history to § 541 makes it clear that the trustee (or debtor in possession) "could take no greater rights than the debtor himself had." House Report No. 95-595, 95th Cong., 1st Sess. 368 (1977); Senate Report No. 95-989, 95th Cong., 2d Sess. 82 (1978). Therefore, the debtor's contingent right of redemption is the only right which became property of the estate and its termination is the only action which possibly could be avoided under § 549. The debtor is, therefore, not entitled to a declaration that it is the owner of the shares. Nor is it entitled to an order returning possession to it. It is not even entitled to an injunction enjoining the NCUAB and Ellsworth from exercising control over the shares. All that the debtor is entitled to is protection of its right of redemption upon nonperformance by Ellsworth. However, in light of the contingent nature of the debtor's interest, the Court believes it would be improvident to grant the debtor any relief under § 549. Avoidance of the closing of the sale at this point would create no rights in the debtor. Only Ellsworth would have the right to refuse performance, and it has indicated its intent to perform by its actual performance postpetition. Relief at this point would simply cause the parties to the contract to incur the extra expense of a second

closing, with the debtor being unable to intervene.[3] This Court cannot justify such a useless act.

Since the Court finds that there is no cause of action under § 549, it need not decide whether Ellsworth is protected under § 550(b).

The Automatic Stay

Section 362(a) of the Bankruptcy Code provides that the filing of a petition in bankruptcy operates as a stay of

> (1) action . . . to recover a claim against the debtor that arose before the commencement of the case;
>
> * * *
>
> (3) any act to obtain possession of property of the estate . . . or to exercise control over property of the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate;
>
> * * *
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case.

I.F.S. argues that the closing of the sale of the SLI shares was a violation of the automatic stay and that any action taken

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One effect of an avoidance of the closing is that the parties need to seek court authorization. However, having considered the circumstances surrounding the Stock Purchase Agreement, the Court contemplates no reason it would deny such a request for approval.

in violation of the stay is void ab inito. Ellsworth argues that such a holding would have the effect of writing §§ 549 and 550(b) out of the Bankruptcy Code: If postpetition transfers of estate property which are violative of the automatic stay are void, there would be no necessity in avoiding them under § 549, nor would there be any available protections to successor transferees under § 550(b).

Without fully addressing those issues, the Court believes that its holding and analysis under § 549 is equally applicable here. To the extent that the NCUAB violated the automatic stay--either because its actions constituted an attempt to collect a debt or because it was attempting to enforce its lien or because it was attempting to obtain property of the estate--debtor's remedy would be no different than under § 549. The only action taken postpetition was the closing of the sale. The only effect the closing had on the estate was to terminate the debtor's contingent rights of redemption. For the reasons set forth herein, the debtor is not entitled to the relief which it has requested even if the closing was void. Were the Court to issue a judgment declaring the closing void, the NCUAB and Ellsworth would only be forced to seek relief from the stay in order to close the sale a second time and the debtor would have no right to intervene. Moreover, the Court believes that it would be appropriate under such circumstances to annul the

automatic stay under § 362(d) to avoid such a futile exercise. Accordingly, the Court holds that I.F.S. is not entitled to relief under § 362.

Fulfillment of Condition Precedent

The debtor's final basis for recovery is that, pursuant to the Pledge and Security Agreement, the NCUAB was obligated to collect on certain letters of credit before it could pursue its remedies under the default clause. Paragraph 8(c) of the Pledge and Security Agreement states that "[i]n the event of any default occurring within two years from the date of this Agreement, for use in curing such default, Lender shall first obtain payment of any defaulted amount by drawing upon the Letters of Credit also provided to the Lender in connection with the Loans."

The Court believes the lender sufficiently complied with the requirements of the Agreement vis-a-vis the Letters of Credit. The NCUAB made formal demands for payment under the Letters of Credit and tendered the appropriate documentation to the issuing banks. The NCUAB contends "that the act of submitting appropriate documentation and attempting to collect under each letter of credit satisfies the requirements of paragraph 8(c)." MEMORANDUM OF NCUAB IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO I.F.S.' MOTION FOR SUMMARY JUDGMENT, pp. 15-16. The Court agrees. The NCUAB did all that it could be expected to do in collecting on the Letters of Credit. To

require more would place unreasonable leverage in the hands of a refusing bank.

CONCLUSION

Property of the estate consists of rights which the debtor has in property it pledges to secure its obligations. However, such estate property is limited to the rights of the debtor as of the date of filing. In this case, those rights consisted solely of a contingent right of redemption which was terminated by the subsequent performance of a third party. The Court refuses to unravel the sale of the stock herein based on such a remote claim since the remedies which the debtor seeks are simply not available to it on the circumstances of this case.

Based on the foregoing, defendants' respective motions for summary judgment are hereby granted and the debtor's motion for summary judgment is denied.

DATED this 27 day of August, 1986.

BY THE COURT:

GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE