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IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

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In re JOHN CLEALUND DURFEE
and GAYLIE DIXON DURFEE
dba Durfee Foods
dba Delta Valley Foods,

Debtors,

Bankruptcy No. 86C-01501

UTAH FARM PRODUCTION CREDIT
ASSOCIATION,

Appellant,

vs.

JOHN C. DURFEE et al.,

Appellees.

MEMORANDUM OPINION
AND ORDER

District Court No. 86C-560-J

86-01501

Appellant, Utah Farm Production Credit Association (PCA),
appeals a bankruptcy court order finding PCA in contempt of court
and in violation of the automatic stay provision of the
bankruptcy code, 11 U.S.C. § 362 (1982 & Supp. III 1985),¹ and
ordering PCA to pay attorney's fees in the amount of \$1,000.
This court holds that PCA has not violated the automatic stay and
is not in contempt of court. This court further holds that
section 362 does not require a creditor with a security interest
in accounts receivable to take any affirmative action instructing
account debtors to pay pre- or postpetition accounts receivable

¹ Unless otherwise indicated, all statutory references are to
title 11 of the United States Code (1982 & Supp. III 1985).

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to the debtor in possession or trustee. The bankruptcy court's order, therefore, is REVERSED.

I.

On August 29, 1985, John Durfee and others (doing business as Durfee Foods and referred to as Durfee or "Debtors") executed a promissory note, promising to pay Old Capitol Valley Cheese ("Valley Cheese") \$469,117 plus interest. Debtors also signed a security agreement, granting Valley Cheese a security interest in, among other things, "all receivables now owned or hereafter acquired" and "all proceeds and products of the foregoing,

. . ."² Debtors defaulted on the note on April 3, 1986. Following this default and pursuant to Utah Code Ann. §§ 70A-9-502 & -318 (1980), Valley Cheese sent demand letters to most of Durfee's account debtors, demanding payment of all accounts directly to Valley Cheese. In April 1986, Valley Cheese assigned its rights in the note and security agreement to PCA, appellant in this action. Notably, PCA has not succeeded in collecting any of the accounts receivable.

In an effort to protect its collateral, PCA obtained a temporary restraining order from a state district court on April

² The enforceability of this security agreement and lien is challenged in a separate adversary proceeding, Durfee v. Utah Farm Credit Prod. Ass'n, which is still pending before the bankruptcy court. For purposes of this appeal, however, the parties have agreed that there is a valid security interest in Durfee's accounts receivable.

8, 1986, restraining Debtors from using or disposing of the accounts receivable and other property constituting PCA's collateral. Two days later, Debtors filed their chapter 11 bankruptcy petition, which was later converted to a chapter 7 petition.

The filing of the bankruptcy petition resulted in the bickering that now exists over the status of the accounts receivable, accounts which no one appears able to collect. Durfee, desiring to collect its receivables, requested that PCA advise account debtors that Valley's demand letters were of no further effect and that they were to pay their accounts directly to Durfee. PCA refused to instruct account debtors absent a court order. During this time, two motions were filed. PCA filed a "Motion to Lift Stay, Objection to Use of Cash Collateral and Motion to Dismiss." Debtors filed a "Motion for Order Authorizing Debtors to Receive Payments on Accounts." The court ruled in the Debtors' favor on their motion on May 6 and entered the order on May 7. PCA then filed a "Motion for Reconsideration and Objection to the Order." On May 8, the court heard arguments on PCA's motion for relief from the stay with respect to the Debtors' prepetition accounts receivable and inventory constituting PCA's collateral. The court ruled in PCA's favor on that motion on May 8 and signed the order on May 16. As a result of these two orders, the stay was lifted as it affected prepetition accounts. Durfee's right to receive payments on its

postpetition accounts, accounts which are not subject to PCA's prepetition security agreement, continued unaltered.³ 5

The court's authorization to receive payments, however, did not help Durfee collect its accounts receivable, and Durfee blamed PCA's earlier demand letters for their lack of success. Durfee, therefore, requested the court to direct PCA to appear and show cause why PCA should not be held in contempt of the court's May 6 ruling and May 7 order. The bankruptcy court issued the requested order to show cause. PCA appeared and on June 11, the court held PCA in contempt of court for following a "course of conduct" "in violation of the automatic stay provisions of Section 362 of the bankruptcy code." Specifically, the court found:

3. [PCA] maintained a course [of conduct] in violation of Section 362(a)(3) through its inaction.

. . .

7. [PCA] had instigated the [state court] proceedings to obtain control and possession of the accounts receivable and could have notified the various account debtors of a cancellation or stay of the effects of those proceedings;

³ See 11 U.S.C. § 552, quoted *infra* note 4. Prepetition accounts receivable are accounts that come into existence prior to the petition in bankruptcy. Under § 552, property (here, accounts receivables) acquired by the debtor or the estate after commencement of the case is not subject to any lien resulting from a prepetition security agreement. 11 U.S.C. § 552. PCA, therefore, may have a valid security interest in the prepetition accounts and their proceeds. Accounts receivable which came into existence after the commencement of the case, however, are not subject to PCA's lien. See Mercantile Nat'l Bank v. Aerosmith Denton Corp. (In re Aerosmith Denton Corp.), 36 Bankr. 116 (Bankr. N.D. Tex. 1983).

8. Debtors were not required to seek a turnover of the accounts receivable from [PCA] pursuant to Section 542 of the Bankruptcy Code in order to be entitled to collect on their accounts receivable;

9. [PCA] was not in possession of the debtors' accounts receivable, but did exercise control over them after obtaining knowledge of the filing of the Chapter 11 petition;

10. [PCA's] course of inaction constituted an act to control property of the estate which was in the possession of third-party account debtors[.]

In its contempt order, the court does not distinguish between prepetition and postpetition accounts receivable. Considering the court's previous orders and the status of property upon filing a bankruptcy petition, however, PCA cannot be in contempt of the automatic stay with respect to prepetition receivables after the May 8 order granting relief from the stay. Thus, for prepetition receivables, PCA's violation of the stay is presumably for the period from the filing of Durfee's bankruptcy petition on April 15 to the Court's order lifting the automatic stay on May 8. For postpetition receivables, PCA apparently has violated the stay continuously from the filing of the petition on April 15.

PCA appeals the bankruptcy court's contempt order, presenting the question of whether section 362 requires a secured creditor that has taken a lawful prepetition collection action on accounts receivable to take some affirmative act vis-a-vis the account debtors absent an order from the court? In other words,

must PCA contact Durfee's account debtors and instruct them to pay the trustee or debtor in possession?

II.

Section 362(a)(4) prohibits any entity from creating, perfecting or enforcing any lien against the estate after commencement of the bankruptcy. Section 362(a)(3) similarly prohibits any entity from performing "any act to obtain possession of property of the estate or to exercise control over property of the estate" once the debtor has petitioned for bankruptcy. The question, therefore, is whether PCA's failure to notify account debtors to pay the Debtor is an act to enforce a lien or an act to control or possess property.

PCA claims that it was entitled to collect the receivables prior to the commencement of the bankruptcy. After Durfee filed its petition, PCA claims it was not required to relinquish its right to collect prepetition accounts, absent a court order and adequate protection under sections 363 and 542, because the receivables were cash collateral. PCA further claims that it has taken no action to control or collect postpetition accounts.

Debtors, on the other hand, claim that the bankruptcy court has determined that PCA does not have control of the collateral but that the collateral is in the control of third parties. Because PCA does not have "control," Debtors claim that section 542 is not applicable. Debtors reject the distinction between

pre- and postpetition accounts and claim that PCA's demand letters are a continuing act to gain possession or control of all accounts receivable. Finally, the Debtors claim that section 362 puts an affirmative obligation on PCA to stop the effect of its prepetition demand letter. Neither party is entirely correct.

A. Prepetition Accounts Receivable

Section 552 limits PCA's interest to prepetition accounts receivable, accounts which came into existence before Durfee filed bankruptcy, and their proceeds.⁴ PCA has a security interest in prepetition accounts receivable but none in postpetition accounts.

Prior to Durfee's petition for bankruptcy, and upon Durfee's default, PCA legally demanded direct payment of the accounts from the account debtors. If PCA had collected these accounts prior to the bankruptcy petition, PCA would have been entitled to the funds because the Debtor does not retain an interest in accounts receivable rightfully collected by the secured party prepetition. See National Equipment & Mold Corp. v. Metropolitan Bank of Lima

⁴ Section 552(a) states:

Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

Subsection (b) extends the security interest to proceeds acquired after commencement of the case if the security agreement provides for a security interest in proceeds.

(In re National Equipment & Mold Corp.), 64 Bankr. 239 (Bankr. N.D. Ohio 1986) (the debtor retains an interest in the receivables unless they have been rightfully collected prior to the bankruptcy petition); Health America of Florida Inc. v. Blue Cross-Blue Shield of Florida, Inc. (In re Health America of Florida, Inc.), 22 Bankr. 268, 269 (Bankr. M.D. Fla. 1982) (IRS allowed to retain cash received prepetition from levy on debtor's accounts receivable). If, however, account debtors paid prepetition accounts to PCA after the bankruptcy petition was filed, the monies collected by PCA would be subject to turnover to the Debtor provided that PCA was given adequate protection. 11 U.S.C. § 542; Rouse v. United States (In re Suppliers, Inc.), 41 Bankr. 520 (Bankr. D. Ky. 1984) (uncollected prepetition accounts receivable are property of the estate).⁵

⁵ Because uncollected prepetition accounts receivable are property that the trustee can use under section 363, they are also property for which turnover may be compelled under section 542. In re Riding, 44 Bankr. 846, 848 (Bank. D. Utah 1984); cf. Health America of Florida, Inc. v. Blue Cross-Blue Shield of Florida, Inc. (In re Health America of Florida, Inc.), 22 Bankr. 268, 269 (Bankr. M.D. Fla. 1982) (IRS prepetition levy on debtor's accounts receivable held by account-debtor Blue Cross subject to § 542 turnover). Turnover, however, will not be required unless adequate protection is provided to the creditor. United States v. Whiting Pools, 462 U.S. 198, 207 (1982) (the secured party "may demand adequate protection as a condition precedent to turnover." (emphasis added)).

PCA claims that not only is it entitled to adequate protection but, because the accounts are cash collateral, Durfee may not use the collateral without consent or notice and hearing and order of the court as provided in section 363(c)(4). It is unclear what PCA is seeking because no accounts have been collected. Only the Debtors' postpetition collection of the prepetition accounts receivable would constitute cash collateral,

PCA did not collect any prepetition accounts receivable after Durfee filed for bankruptcy and before the court granted relief from the stay on May 8. Thus there is nothing for PCA to turn over. PCA, as a result of the May 8 order, is now entitled to collect those accounts.

Durfee does not contest the order lifting the stay and does not now seek to collect or use the prepetition accounts. Nonetheless, Durfee appears to argue that, prior to the lifting of the stay, the unrescinded demand letters were a continuing act to enforce a lien against the property of the estate in violation of the automatic stay. Based on the reasons set forth below with respect to postpetition accounts receivable, the court concludes that PCA took no further action to enforce its lien on prepetition accounts. The court further concludes that there is no continuing act in violation of the stay with respect to either pre- or postpetition accounts.

B. Postpetition Accounts Receivable

Durfee argues that PCA's prepetition demand letters also are inhibiting Durfee's collection of postpetition accounts receivable and, until rescinded by PCA, account debtors will not

subject to PCA's security interest and section 363(c)(4). Mercantile Nat'l Bank v. Aerosmith Denton Corp. (In re Aerosmith Denton Corp.), 36 Bankr. 116 (Bankr. N.D. Texas, 1983); 2 Collier on Bankruptcy, 363.02 (1986). Since no accounts have been collected, there is no cash collateral at issue between the parties.

pay Durfee in spite of the court's authorization of payment to Durfee. Thus Durfee claims that the letters are a "continuing act" to possess or control the postpetition accounts in which PCA has no legal interest under section 552. Relying on Elder v. City of Thomasville (In re Elder), 12 Bankr. 491 (Bankr. M.D. Ga. 1981), Durfee further contends that the automatic stay provision of the bankruptcy code requires PCA to take affirmative acts with respect to these accounts.

In Elder, continuing garnishment proceedings were filed against the debtor prior to his bankruptcy petition. As a result of the garnishment, the garnishee withheld monies from the debtor's pay. The legal effect of the garnishment proceeding and thus the withholding continued after the garnishee was notified of the bankruptcy proceedings initiated by the debtor. The court held that, upon notice of the bankruptcy, either the garnishor should dismiss or stay the garnishment, or the garnishee should pay the debtor all sums withheld and answer the garnishment by reciting that the debtor filed bankruptcy. Positive acts by the garnishee or garnishor, therefore, were required to give effect to the automatic stay. Failure to take such positive acts, according to Elder, are a violation of the stay.

PCA's demand letters to Durfee's account debtors were a single act to collect prepetition accounts receivable that PCA had a legal right to collect upon the Debtor's default. This action is distinguishable from the continuing writ of garnishment

in Elder. However, even without making this distinction, Elder is not controlling in this jurisdiction, and this court does not accept its rationale. While agreeing with Elder that a garnishee, upon notice from whatever source of the debtor's bankruptcy, should not withhold additional funds from the debtor's wages, this court would not go so far as the court in Elder did, see id. at 495, and require the garnishor to advise the garnishee to surrender withheld funds to the debtor. Similarly, in this case, when the account debtors received notice of Durfee's bankruptcy, they were required to pay the debtors all outstanding accounts receivable and to ignore PCA's demand letters with respect to the prepetition accounts. PCA, however, is not required to notify the account debtors of the effect of the automatic stay and to advise them to pay the Debtor. If the account debtors, unaware of Durfee's bankruptcy, inadvertently paid PCA in accordance with the demand letters, the payment, so far as the account debtors are concerned, would be made as if the debtor was not in bankruptcy. 11 U.S.C. § 542(c).⁴ However, if the payments were made to PCA postpetition, the monies collected

⁴ Section 542(c) states:

[A]n entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith . . . to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

11 U.S.C. § 542(c).

would be property of the estate that PCA would be required to turn over.⁷ Durfee's complaint is not with PCA (who has not been fortunate enough to even collect the funds that it can rightfully claim), but rather with the account debtors.⁸

Finally, to assert that PCA has a duty to act is inconsistent with the bankruptcy code. Sections 704 and 1106 specify the duties of the debtor in possession and of the trustee.⁹ The trustee is required to "[f]ile a list of creditors, . . . a schedule of assets and liabilities, a schedule

⁷ Whether PCA would be entitled to adequate protection would depend on whether the payment related to a pre- or post-petition account receivable. See supra note 5 and accompanying text.

⁸ It may be that Durfee decided to proceed against PCA rather than against the account debtors because Durfee perceived it to be the more direct route. Some authority suggests that the debtor may not proceed against prepetition account debtors in a turnover action until the debtor's claims are liquidated in a court of competent jurisdiction or by agreement of the account debtors. Satelco, Inc., v. N. Am. Publishers (In re Satelco, Inc.), 58 Bankr. 781 (Bankr. N.D. Tex. 1986) (no jurisdiction to adjudicate debtor's turnover request to collect accounts receivable); Century Brass Products, Inc. v. Millard Metals Service Center, Inc. (In the Matter of Century Brass Products, Inc.), 58 Bankr. 838 (Bankr. D. Conn. 1986) (an order to turn over property of the estate does not include action to collect upon an account receivable, even if the account receivable is property subject to turnover under § 542(b)).

⁹ This case originally commenced as a chapter 11 petition with Durfee as debtor in possession. Thus § 1107 applied at that time. It was later converted to a chapter 7, making § 704 applicable. Under section 1107, a debtor in possession essentially has the same duties as a trustee. 11 U.S.C. §§ 704, 1106-07; In re Unr Industries, Inc. 30 Bankr. 609 (Bankr. N.D. Ill. 1983). For purposes here, the differences between the two are not important, and this opinion will refer to the trustee as the responsible person, not the debtor in possession.

of current income and current expenditures, and a statement of the debtor's financial affairs." 11 U.S.C. § 521(1); see also 11 U.S.C. § 1106(2) & Bankr. R. 1007(b). Further, the trustee is directed to "collect and reduce to money the property of the estate . . ." 11 U.S.C. § 704(1); see also In re Semel, 411 F.2d 195 (3d Cir. 1969) (trustee has a duty to collect property of the estate); 4 Collier on Bankruptcy 704.04 & n.1 (trustee has a duty to realize on collectible debts). Similarly, rule 2015(4) requires the trustee to "give notice to every person known to be holding money or property subject to withdrawal or order of the debtor" unless previously notified of the case. Thus any action that is required with respect to the debtor's assets, including the accounts receivable, is an action required of the trustee, not of the secured party with an interest in the asset.

III.

This action is a fight over property that neither party has but in which both may have an interest. PCA's interest in the accounts receivable is limited to prepetition accounts and the proceeds from those accounts, and possibly to a share of postpetition accounts as an unsecured creditor. Had PCA collected any of the accounts receivable prior to the bankruptcy petition, PCA would be entitled to dispose of the cash. No accounts, however, were collected. Upon filing of Durfee's petition, the automatic stay went into effect. Had PCA collected

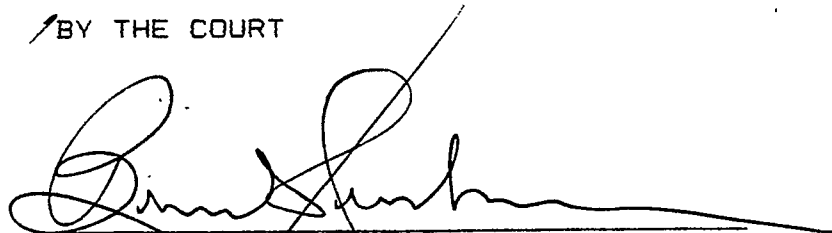
the prepetition accounts after the filing of the bankruptcy petition, the funds collected would constitute property of the estate subject to turnover provided that PCA was given adequate protection. Such action now is unnecessary in light of the court's order granting relief from the stay, and PCA is free to pursue its interest in the prepetition accounts. Monies that the Debtors collect on postpetition account receivables are property of the estate free of PCA's lien under section 552.

PCA's demand letters do not constitute a continuing course of conduct either to enforce its lien on prepetition accounts or to control postpetition accounts in violation of the stay. Furthermore, PCA is not required to inform the account debtors that they could ignore PCA's earlier demand letters. PCA is not legally required to do the Debtors' work. Because PCA's demand letters and its failure to rescind their effect do not violate the automatic stay provisions of the bankruptcy code, the bankruptcy court's order holding otherwise and finding PCA in contempt of court is REVERSED.

So ordered.

Dated this 12 day of Dec., 1986.

BY THE COURT



Bruce S. Jenkins, Chief Judge
United States District Court