11 U.S.C. § 544(a)
ORS 79.1050(1)(d)
Security Interest
Perfection

Hostmann v. Captial Consultants, Inc. et al., Adv. No. 97-3138
In re WS, Inc., Case No. 394-36434-dds7

11/18/97 DDS Unpublished

Chapter 7 trustee brought adversary proceeding pursuant to 11 U.S.C. § 544(a) to avoid any security interest held by Capital Consultants, Inc. ("CCI") and/or Cascade General, Inc.("CGI") in certain claims which Debtor had against third parties for services Debtor provided the third parties during the course of its ship repair operations. The facts of the case were complicated and involved two major restructurings of obligations which Debtor owed to CCI.

The court held that CCI was continuously perfected in the "Government Contract Claims." Debtor transfered the Government Contract Claims to a related entity as part of one restructuring. That transfer of assets was later declared by the parties to be void "ab initio." However the related entity had relieved the debtor of its payment obligation. The trustee asserted that because Debtor was relieved of its payment obligation to CCI there was no debt to support the security interest in Debtor's assets which was reflected in CCI's security agreement.

ORS 79.1050(1)(d) defines "debtor" to include the owner of collateral who does not owe payment or other performance of the obligation secured. Debtor continued to be a "debtor" so long as its assets were pledged as collateral for the CCI obligation, no matter who owed the money to CCI.

Additionally, the court held that CCI had a perfected security interest in the "ARCO Alaska Claim" directly from Debtor or through Debtor's related entity. First, the security interest in the ARCO Alaska Claim was granted through a collateral assignment where CCI's financing statement recited that CCI had an interest in all of Debtor's accounts and contract rights. Second, although the Debtor assigned the ARCO Alaska Claim to its related entity which did not perfect its interest in the ARCO Alaska Claim, CCI 's security interest in the related entity's accounts attached to the ARCO Alaska Claim at the time of the assignment from the Debtor.

CLERK, U.S. BANKRUPTCY COURT
DISTRICT OF OREGON

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UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re: WS, INC., dba West State, Inc., Debtor.	Bankruptcy Case No. 394-36434-dds7
EDWARD C. HOSTMANN, Trustee of the Bankruptcy Estate of WS, Inc., Plaintiff, v. CAPITAL CONSULTANTS, INC., an Oregon corporation; and CASCADE GENERAL, INC., an Oregon corporation, Defendants.	Adv. Proc. No. 397-3138-dds FINDINGS OF FACT AND CONCLUSIONS OF LAW RELATING TO CROSS-MOTIONS FOR SUMMARY JUDGMENT

Prior to the petition date WS, Inc. ("WSI"), the debtor, operated a ship repair yard. The chapter 7 trustee ("Trustee") filed this adversary proceeding seeking to avoid, pursuant to 11 U.S.C. § 544(a), any security interest held by Capital Consultants, Inc. ("CCI") and/or Cascade General, Inc. ("Cascade")

in certain claims which WSI had against third parties, which claims arose from services WSI provided those third parties during the course of its operations. The parties (the Trustee as plaintiff, CCI and Cascade as co-defendants) filed cross motions for summary judgment. At oral argument on the cross motions the parties agreed that the matter could be treated as a trial on stipulated facts.

Three classes of claims are involved in this litigation. The first class, referred to as the "Government Contract Claims," includes claims which WSI asserts with respect to repair work on the following vessels: Cape Blanco, Cape Fear, Cape Breton, Northern Light, Polar Star, Triumph, and Utrillo. The second class consists of WSI's claim with respect to repair work on the ARCO Alaska ("ARCO Alaska Claim"). The third class consists of WSI's claim with respect to repair work on the Tacoma ("Tacoma Claim"). By stipulation of the parties, the Trustee has substantially liquidated the claims and is holding the proceeds pending determination of the issues in this adversary proceeding.

The Trustee contends that there is no security agreement between CCI and WSI to give CCI an interest in the Government Contract Claims, the ARCO Alaska Claim, or the Tacoma Claim. The Trustee also contends that WSI owes no debt to CCI to support any alleged security interest.

I find that CCI has a perfected security interest in the Government Contract Claims and in the ARCO Alaska Claim. At oral argument, CCI conceded that it was unperfected as to the Tacoma

Claim. Accordingly, I find that CCI is entitled to judgment with respect to the Government Contract Claims and the ARCO Alaska Claim, and that the Trustee is entitled to judgment with respect to the proceeds of the Tacoma Claim. My reasons follow.

I. BACKGROUND.

The facts of this case are complicated and involve two major restructurings of obligations which WSI owed to CCI. The first restructuring took place in November of 1993 and is referred to by the parties as the Marine Finance Corporation transaction ("the MFC Transaction"). The second restructuring took place in October of 1994 and is referred to by the parties as the Ponderosa Transaction.

As part of the pleadings submitted as the record relating to the cross motions for summary judgment the parties stipulated to certain facts, which are incorporated herein as necessary.

Beginning in about 1990, CCI began providing loans to WSI. According to the Trustee, three of those loans are relevant to this proceeding: the "Real Estate Loan," the "Uninsured Line of Credit" and the "Port of Portland Loan." The Real Estate Loan and the Uninsured Line of Credit are primarily relevant to the MFC Transaction. The Port of Portland Loan is primarily relevant to the Ponderosa Transaction.

A. The MFC Transaction (November 1993).

Marine Finance Corporation ("MFC"), an affiliate of WSI, was incorporated in connection with the restructuring of certain loans which WSI owed to CCI. The stipulated facts and a review of the

exhibits reflect the following chronology which relates to the MFC Transaction.

1. The Real Estate Loan. On February 16, 1990, CCI loaned WSI $500,000, which is referred to as the Real Estate Loan. To secure repayment of the Real Estate Loan WSI, also on February 16, 1990, executed a security agreement which granted CCI a security interest in, among other things:

> "All of Debtor's receivables, accounts, contract rights, instruments, documents, chattel paper or general intangibles for any obligation or indebtedness of any kind owed to Debtor; and all rights of debtor to receive any payments of money or other value for such obligations or indebtedness, whether now existing or hereafter arising and whether in exchange for goods, services, or otherwise arising in favor of Debtor."

On February 26, 1990, CCI recorded a financing statement perfecting CCI's interest. On June 10, 1991, CCI loaned WSI additional funds under the terms of the Real Estate Loan. As of November 19, 1993, the balance of the Real Estate Loan was $986,993.71.

2. The Uninsured Line of Credit. On October 15, 1991, CCI and WSI entered into a loan agreement pursuant to which CCI agreed to make a loan to WSI in the form of a line of credit ("Uninsured Line of Credit"). To secure repayment of the Uninsured Line of Credit, WSI executed a Security Agreement and Assignment of Accounts Receivable in favor of CCI. On November 19, 1993, the balance on the Uninsured Line of Credit was $3,435,000.

The parties stipulate that CCI had a valid perfected security interest in the Government Contract Claims on November 18, 1993. This security interest was reflected in the security agreements for

the Real Estate Loan and the Uninsured Line of Credit, in the UCC financing statement filed in connection with the Real Estate Loan, and in a "Polar Star Financing Statement." On November 18, 1993, WSI granted CCI a further security interest in the Government Contract Claims and their proceeds by executing seven documents, each entitled "Collateral Assignment of Contract Rights, Accounts Receivable and Proceeds of Claim" relating to each of the Government Contract Claims.

3. The MFC Restructuring. In the fall of 1993, WSI was obligated to CCI for the Real Estate Loan and the Uninsured Line of Credit. Additionally, one of WSI's affiliates owed to CCI an obligation known as the "HC Loan." On or about November 19, 1993, WSI, affiliates of WSI, and MFC entered into an asset purchase agreement. Under the agreement WSI transferred to MFC all of its rights and interest in the Government Contract Claims. On the same date, CCI, MFC and WSI entered into an agreement, the "Consent, Assumption, Modification and Consolidation Agreement" (hereinafter "Consolidation Agreement"), pursuant to which MFC assumed and agreed to pay and perform all of WSI's financial obligations and covenants under the Real Estate Loan and the Uninsured Line of Credit. Under the Consolidation Agreement, the loans assumed by MFC were consolidated into a single indebtedness totaling $8,564,892. This amount included an additional advance from CCI to MFC in the amount of $1,835,526.10. The consolidated indebtedness is evidenced by two notes executed by MFC on November 19, 1993. Each note states that

the consolidation is intended to supersede the instruments evidencing the prior indebtedness referred to in the Consolidation Agreement.

Also on November 19, 1993, MFC executed a security agreement which granted CCI a security interest in all of MFC's assets in order to secure the consolidated indebtedness. WSI and MFC jointly executed (1) an amendment to the Real Estate Loan financing statement, designating MFC as an additional party (Exhibit 1, page 69), and (2) a new financing statement in favor of CCI which described all of the Government Contract Claims, except for the Polar Star claim (Exhibit 1, page 85). These financing statements were recorded on December 1, 1993. Additionally, WSI and MFC jointly executed an amendment to the Polar Star financing statement, which was recorded on December 10, 1993 (Exhibit 1, page 80).

Thereafter, on August 26, 1994, CCI made an additional advance to MFC in the amount of $975,000, increasing the principal amount of the consolidated indebtedness to $9,909,892.

B. Other Transactions Relating to the Government Contract Claims.

As previously stated, on November 18, 1993, WSI executed a "Collateral Assignment of Contract Rights, Accounts Receivable and Proceeds of Claim" relating to each of the Government Contract Claims. Although the Government Contract Claims were transferred to MFC in conjunction with the MFC Transaction, on October 26, 1994, WSI and MFC executed a Rescission Agreement, which was consented to by CCI, whereby the transfer of the Government Contract Claims was

rescinded "ab initio." At oral argument the parties speculated that the Rescission Agreement was executed in an effort to protect the Government Contract Claims from a defense by the government under the Assignment of Claims Act (41 U.S.C. §15).

C. The Ponderosa Transaction (October 1994)

In addition to the Real Estate Loan and the Uninsured Line of Credit, at the time of the MFC Transaction WSI also owed CCI an obligation known as the Port of Portland Loan. The Port of Portland Loan and the Denali Loan were further obligations of WSI which were included in the Ponderosa Transaction.

1. The Port of Portland Loan. On June 28, 1991, CCI loaned WSI $1,950,000, evidenced by a promissory note. By April of 1992, all but $137,500 of this amount had been repaid. A replacement promissory note was executed by WSI on April 3, 1992, reflecting the reduced obligation. The Port of Portland Loan was not included in the MFC restructuring and continued to be an obligation of WSI after November 19, 1993.

2. The Denali Loan. Subsequent to the MFC restructuring, CCI loaned WSI $500,000, which was evidenced by a promissory note dated February 18, 1994. As security for the repayment of the Denali loan, WSI executed an Assignment of Contract Rights and Accounts Receivable, which granted CCI a security interest in WSI's rights to receive payments under a specific contract for repair and maintenance work performed by WSI on the SS Denali. When WSI could not pay the Denali loan by the original maturity date, CCI agreed to

extend the maturity date on the condition that CCI also be granted a security interest in WSI's rights to receive payments under its contract with ARCO Marine. On March 25, 1994, WSI and CCI entered a loan modification agreement which amended the Assignment to include the ARCO Marine contract rights.

WSI's financial condition continued to deteriorate in the fall of 1994.

3. The Ponderosa Transaction.

On October 27, 1994, Cascade, MFC, WSI (and its affiliates), and CCI entered into the Cascade Consolidation Agreement. Under the Cascade Consolidation Agreement, Cascade unconditionally assumed and agreed to pay and perform all of WSI's financial obligations and covenants owed to CCI pursuant to the Denali loan and the Port of Portland loan. The parties stipulated that as of October 27, 1994, the balance on the Denali loan was $500,000 and the balance on the Port of Portland loan was $115,942. Cascade also unconditionally assumed and agreed to pay $6,244,432.62 of the MFC consolidated indebtedness. These obligations were evidenced by a note Cascade executed in favor of CCI dated October 27, 1994. The Cascade Consolidation Agreement provided that the note would supersede and replace the promissory notes previously evidencing the consolidated

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indebtedness[1] and the notes evidencing the Denali loan and the Port of Portland loan.

Also on October 27, 1994, MFC and WSI conveyed to Cascade all right, title and interest in certain personal property, equipment, and inventory. The collateral did not include the Government Contract Claims, the Tacoma Claim, or the ARCO Alaska Claim.

On October 27, 1994, Cascade, CCI and WSI executed a security agreement which contained a statement that WSI acknowledged that notwithstanding the execution of this security agreement, the collateral assignments of contract rights, accounts receivable and proceeds of sales granted by WSI to CCI on or about November 15, 1993 continued to be valid and binding security for obligations assumed by Cascade.

The financing statement executed by Cascade in favor of CCI was filed October 29, 1994.

D. The Bankruptcy.

An involuntary chapter 7 petition was filed against WSI on October 27, 1994 and an order for relief was entered on November 3, 1994.

The trustee seeks to avoid the security interests which CCI and Cascade claim in contract proceeds on the bases that (1) on the petition date WSI was not indebted to either CCI or Cascade and (2)

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[1]$3,645,000 of the principal balance of the MFC consolidated indebtedness was not assumed by Cascade but instead became a joint obligation of MFC and Astoria Metal Corporation under separate loan documents in favor of CCI as of October 27, 1994.

on the petition date no security agreement was in effect which granted either CCI or Cascade a security interest in the contract proceeds.

II. DISCUSSION.

CCI had a valid perfected security interest in the proceeds of the Government Contract Claims as a result of the Collateral Assignments, notwithstanding the MFC Transaction, the subsequent Rescission Agreement, and the Ponderosa Transaction. As noted previously, the parties have stipulate that as of November 18, 1993, CCI had a valid perfected security interest in the Government Contract Claims.

A. CCI's Security Interest Continued Through October 26, 1994.

The Trustee asserts that because WSI was relieved of its payment obligations to CCI by virtue of the MFC Transaction on November 19, 1993, there is no debt to support the security interest in the CCI's security agreement. I agree with the Trustee that both Uninsured Line of Credit Security Agreement (executed in conjunction with the Uninsured Line of Credit) and the WSI Security Agreement (executed in conjunction with the Real Estate Loan) were "replaced and superseded" by the Consolidated Security Agreement executed by MFC as a part of the MFC Transaction. Exhibit 7, paragraphs 3.2.2(b) and 3.2.3(a). However, the Collateral Assignments were expressly ratified and reaffirmed by WSI (Exhibit 7, paragraph 1.3),

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and modified to secure repayment of the consolidated indebtedness owed by MFC (Exhibit 7, 3.2.2(3)).

Additionally, I find unpersuasive the Trustee's argument that because WSI no longer owed a debt to CCI any security agreement or security interest was invalid. While WSI may no longer have had a personal obligation to CCI as a result of the MFC Transaction, that does not mean that no debt existed. On the contrary, a substantial debt existed, which MFC assumed as part of the MFC Transaction. O.R.S. 79.1050(1)(d) defines "debtor" to include the owner of collateral who does not owe payment or other performance of the obligation secured. Thus WSI continued to be a debtor so long as its assets were pledged as collateral for the CCI obligation, no matter who owed the money to CCI.

So long as WSI signed a security agreement which contained a description of the collateral (here, the Collateral Assignments), CCI gave value (first the Uninsured Line of Credit, then the consolidated indebtedness), and WSI had rights in the collateral, the security interest attached. O.R.S. 79.2030. WSI had rights in the Government Contract Claims prior to November 19, 1993. CCI perfected its security interest in the Government Contract Claims by filing a UCC-1 financing statement on December 1, 1993. See Exhibit 10-A. There has been no lapse in the UCC-1 financing statement.

Although the Government Contract Claims were initially transferred to MFC as a part of the MFC Transaction, as a result of the Rescission Agreement that transfer was void "ab initio."

Accordingly, WSI never lost its rights in the Government Contract Claims and CCI was continuously perfected in the Government Contract Claims.

B. CCI's Security Interest in the Government Contract Claims Continued, Notwithstanding the Ponderosa Transaction.

CCI's security interest in the Government Contract Claims granted through the Collateral Assignments were expressly continued in the Ponderosa Transaction to secure repayment of the obligation now owed by Cascade. See Exhibit 15, Recitals E and G, and paragraph 3.2.2(b).

C. CCI Has a Valid Perfected Security Interest in the ARCO Alaska Claim.

CCI claims a valid perfected security interest in the ARCO Alaska Claim both directly from WSI as well as from MFC as a result of the MFC Transaction.

CCI's claim of a security interest in the ARCO Alaska Claim arises out of the Denali Loan. WSI executed a security agreement, in the form of a collateral assignment, granting CCI a security interest in WSI's contract rights relating to the SS Denali. See Exhibit 12. This security agreement was later modified to include the grant of a security interest in WSI's contract rights relating to the ARCO Alaska Claim.

CCI has a financing statement on file which was signed by WSI before the collateral assignment of the ARCO Alaska Claim and which was signed by WSI during numerous subsequent amendments. (Exhibit

4). This financing statement, which recites that CCI has an interest in all of WSI's accounts and contract rights, is sufficient to perfect CCI's security interest in the ARCO Alaska Claim which was granted through the collateral assignment.

Despite the Trustee's contention to the contrary, WSI assigned the ARCO Alaska Claim to MFC on or about October 26, 1994. See Affidavit of Charles P. Starkey ("Starkey Affidavit"), Exhibits C and D.

The record does not reflect that MFC perfected its interest in the ARCO Alaska claim. The defendants assert that the prepetition transfer of the ARCO Alaska claim to MFC was excluded from the application of Article 9 of the Uniform Commercial Code because "the transfer of the ARCO Alaska account was a discrete transaction involving a single account and *was given in whole satisfaction of a preexisting indebtedness.*" (Emphasis added). The record reflects otherwise. Exhibit C, page 2 to the Starkey Affidavit recites that WSI's Board of Directors made the assignment to MFC "so that [MFC] shall give a loan to [WSI] based on that receivable." Exhibit D, page 2 to the Starkey Affidavit recites that MFC's Board of Directors agreed to make a loan to WSI based on receipt of the assignment: "[MFC] shall lend to [WSI] at least $975,000 in consideration of the assignment of the ARCO claim to [MFC]." I find no basis under O.R.S. 79.1040 to exclude from the application of Article 9 the transfer of the ARCO Alaska claim from WSI to MFC.

However, notwithstanding MFC's lack of perfection of a security interest in the ARCO Alaska Claim, I find that CCI's security interest in MFC's accounts, granted in the Security Agreement executed by MFC in favor of CCI on November 19, 1993 (Exhibit 9) and perfected by the amended financing statement executed in conjunction with the MFC Transaction (Exhibit 1, page 69) attached at the time of the assignment from WSI to MFC.

Thus, CCI has a valid security interest in the ARCO Alaska Claim either directly from WSI or through MFC.

III. CONCLUSION.

At the time the order for relief was entered in this case, CCI held a valid perfected security interest in the Government Contract Claims and in the ARCO Alaska Claim. As previously conceded by CCI, at the time the order for relief was entered in this case, CCI was unperfected with respect to the Tacoma Claim.

The foregoing constitute my findings of fact and conclusions of law. I will enter a separate order consistent with the foregoing.

DONAL D. SULLIVAN
Bankruptcy Judge

cc: Fred M. Granum, Esq.
Trish M. Brown, Esq.
Linda Johannsen, Esq.