

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
CHARTWELL HEALTHCARE, INC.,	§	CASE NO. 98-38546-SAF-7
DEBTOR.	§	
	§	
<hr/>		
IN RE:	§	
	§	
EAST TEXAS HEALTHCARE, INC.,	§	CASE NO. 98-38547-SAF-7
et al.,	§	(JOINTLY ADMINISTERED)
DEBTORS.	§	
	§	
<hr/>		
DIANE G. REED and JOHN LITZLER,	§	
PLAINTIFFS,	§	
	§	
vs.	§	ADVERSARY NO. 99-3273
	§	
HELLER HEALTHCARE FINANCE,	§	
INC., et al.	§	
DEFENDANTS.	§	

MEMORANDUM OPINION AND ORDER

Diane G. Reed, the Chapter 7 trustee of the bankruptcy estates of thirty-seven subsidiaries of Chartwell Healthcare, Inc., moves the court for partial summary judgment against the East Texas Noteholders. The trustee seeks a declaration that the Noteholders have no enforceable security interest in the accounts receivable of several of the subsidiaries or in any of the proceeds of the accounts receivable, including the proceeds held by the trustee. The Noteholders oppose the motion and cross-

move for partial summary judgment concerning the proceeds of receivables of East Texas Healthcare I, Inc., and East Texas Healthcare II, Inc.

Heller Healthcare Finance, Inc., moves the court for partial summary judgment against the Noteholders seeking a declaration that the Noteholders do not hold a first, valid, prior and perfected security interest in the accounts receivable of several of the Chartwell subsidiaries. The Noteholders oppose that motion as well.

By order entered February 22, 2001, the court bifurcated the issues in this adversary proceeding and directed that it would first consider the general issue of whether the Noteholders can establish that they hold valid and perfected liens under the Uniform Commercial Code.

Specifically, as relevant to the instant motions, in counts one and three of the second amended complaint the trustee alleges that the Noteholders do not hold a security interest in the accounts receivable of specific subsidiaries of Chartwell Healthcare, Inc., namely, Crockett Nursing Center, Inc., Lampasas Healthcare, Inc., Marshall Healthcare, Inc., Dallas Healthcare, Inc., Seymour Healthcare, Inc., Westgrove Healthcare, Inc., Manhattan Healthcare, Inc., Glenwood Nursing Center, Inc., Chartwell of Fayette, Inc., Chartwell of Platte City, Inc., Colonial Nursing Center, Inc., El Ponce DeLeon Healthcare, Inc.,

Fredericktown Healthcare, Inc., Jupiter Healthcare, Inc., Oak Hill Healthcare, Inc., Pensacola Healthcare, Inc., Cedars Nursing Center, Inc., Brookside Nursing Center, Inc., Arch Creek Healthcare, Inc., Mark Twain Nursing Center, Inc., Jackson Manor Healthcare, Inc., Silex Management Co., Inc., Holly Point Healthcare, Inc., Chartwell of Carrollton, Inc., Snapper Creek Healthcare, Inc., Lincoln Manor Nursing Center, Inc., Ramona Villa Nursing Center, Inc., and Deerbrook Nursing Center, Inc.

In count three of their counterclaim, the Noteholders contend that they do indeed hold a security interest in the accounts receivable of those entities, through a security interest conveyed by their respective parent corporations, namely, East Texas Healthcare, Inc., Chartwell Healthcare of Florida, Inc., Chartwell Healthcare Services of Missouri, Inc., C.M., Inc., Chartwell Healthcare Services of Florida, Inc., Chartwell Healthcare of Missouri, Inc., and Chartwell Home Healthcare, Inc. The trustee's motion and the Noteholders' cross-motion seek summary judgment on these claims, respectively.

In addition, the Noteholders seek summary judgment on counts one and two of their counterclaim concerning a security interest in the accounts receivable and their proceeds of East Texas Healthcare I, Inc., and East Texas Healthcare II, Inc. The trustee does not oppose that motion.

By cross-complaint, the Noteholders allege that they hold a prior perfected security interest in these several accounts receivable superior to Heller's liens. Heller contests that position. In its summary judgment motion, Heller seeks a declaration that the Noteholders do not hold a first, valid, prior and perfected security interest in and liens on the accounts receivable of these entities. The Noteholders cross move for summary judgment on the issue of the lien priority with Heller.

The court held a hearing on the motions on May 9, 2001.

Determinations of the validity, extent, or priority of liens constitute core matters over which this court has jurisdiction to enter a final order. 28 U.S.C. §§ 157(b)(2)(K) and 1334.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, and other matters presented to the court show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law.

Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby Inc., 477 U.S. 242, 250 (1986); Washington v. Armstrong World Indus., 839 F.2d 1121, 1122 (5th Cir. 1988). On a summary judgment motion the inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson, 477 U.S. at 255. A

factual dispute bars summary judgment only when the disputed fact is determinative under governing law. Anderson, 477 U.S. at 250.

The movant bears the initial burden of articulating the basis for its motion and identifying evidence which shows that there is no genuine issue of material fact. Celotex, 477 U.S. at 322. The respondent may not rest on the mere allegations or denials in its pleadings but must set forth specific facts showing that there is a genuine issue for trial. Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). The court applies the same standards to the cross-motion for partial summary judgment.

Evidentiary Issues

The Noteholders present as summary judgment evidence the affidavit of Barkley Clark, a partner in the law firm of Shook, Hardy & Bacon, LLP. He teaches secured transactions at the Georgetown University Law Center. Heller moves to strike the affidavit. The court does not admit lawyer opinion testimony on a question of law. The court therefore grants the motion to strike. The court may, however, consult Clark's treatise, The Law of Secured Transaction, in its analysis of the law.

The Noteholders also seek to present evidence of the consolidation of the nursing home subsidiary bankruptcy estates with their respective parent corporation's bankruptcy estates and evidence of Heller's knowledge of the Noteholders' financing

agreements. In the underlying bankruptcy cases, the court consolidated the subsidiaries with their respective parent corporation's bankruptcy estates without prejudice to the lien questions at issue in this adversary proceeding. Heller's knowledge is not relevant to the U.C.C. lien issue.

Facts

There is no genuine issue of material fact that, except for East Texas Healthcare I, Inc., and East Texas Healthcare II, Inc., none of the subsidiary corporations identified by the trustee granted a security interest in their accounts receivable to the Noteholders. There is also no genuine issue of material fact that the following corporations did grant a security interest in the receivables of their facilities to specific Noteholders: East Texas Healthcare I, Inc., East Texas Healthcare II, Inc., East Texas Healthcare, Inc., Chartwell Healthcare of Florida, Inc., Chartwell Healthcare Services of Florida, Inc., Chartwell Healthcare of Missouri, Inc., Chartwell Healthcare Services of Missouri, Inc., and Chartwell Home Healthcare, Inc.

There is no genuine issue of material fact that East Texas Healthcare I, Inc., d/b/a Merritt Plaza Rehabilitation Center issued notes to the following persons in the following amounts:¹

¹In reviewing the notes at issue in this litigation, it appears that some notes contain misspellings and/or are incomplete. The court is not, through this order, rendering judgment as to particular notes. Therefore, the court does not address the implications, if any, of facially ambiguous notes.

Jay Gordon	\$25,000
Tyrone E. Davenport, IRA	\$25,000
Christie Davenport c/o Tyrone E. Davenport, Trustee	\$4,000
Heather Davenport c/o Tyrone E. Davenport, Trustee	\$8,500
Melanie Davenport c/o Tyrone E. Davenport, Trustee	\$4,000
Travis Davenport c/o Tyrone E. Davenport, Trustee	\$8,500
Joyce Ann Davenport	\$25,000
O.L. Kimbrough	\$50,000
O.L. Kimbrough	\$13,000
O.L. Kimbrough	\$12,500
Edward Mack	\$50,000
Pat Collier	\$25,000
Mike Collier	\$25,000

With the notes, the corporation issued a financing agreement to each noteholder granting "a first mortgage on [the amount of the note divided by the total offering] of seventy-five percent (75%) of the receivables of the nursing homes under lease to East Texas Healthcare I, Inc." The total offering was \$800,000. The financing agreement was not filed with the Secretary of State of Texas.

There is no genuine issue of material fact that East Texas Healthcare II, Inc., d/b/a/ Colonial Park Nursing Home issued notes to the following persons in the following amounts:

H.A. Orgain	\$25,000
Edward Mack	\$50,000
Alicia Mack c/o Edward Mack, Trustee	\$25,000
Adam Taylor Mack c/o Edward Mack, Trustee	\$25,000

Pat S. Collier	\$25,000
Mike Collier	\$25,000

With the notes the corporation executed a financing agreement granting "a first mortgage on [the amount of the note divided by the total offering] of seventy-five percent (75%) of the receivables of the nursing homes under lease to East Texas Healthcare II, Inc." The total amount of the offering was \$1,200,000. The financing agreements were not filed with the Texas Secretary of State.

There is no genuine issue of material fact that East Texas Healthcare, Inc., owned the stock of East Texas Healthcare I, Inc., East Texas Healthcare II, Inc., Marshall Healthcare, Inc., Lampasas Healthcare, Inc., Crockett Nursing Center, Inc., and Seymour Healthcare, Inc. East Texas Healthcare, Inc., issued notes to the following persons in the following amounts:

W.M. Matthews, Jr.	\$60,000
O.L. Kimbrough	\$10,000
Edward Mack	\$100,000
Clark Collier Orren c/o Alison Blair Collier and Milton Orren, Trustees	\$20,000
Clark Collier Orren c/o Alison Blair Collier Orren, Trustee	\$20,000
Joel Patrick Collier, Jr. c/o Joel Patrick Collier and Karen Williams Collier, Trustees	\$20,000
Joel Patrick Collier, Jr. c/o Joel Patrick Collier and Karen Williams Collier, Trustees	\$20,000

With the notes, the corporation executed financing agreements granting "a first mortgage on [the amount of the note divided by

the total offering] of seventy-five percent (75%) of the receivables of the nursing homes under lease to East Texas Healthcare, Inc." The total offering was \$2,000,000. There were no nursing homes under lease to the corporation. All the nursing homes were under lease to the subsidiary corporations. The financing agreements were not filed with the Texas Secretary of State.

There is no genuine issue of material fact that Chartwell Healthcare of Florida, Inc., owned the stock of Jackson Manor Healthcare, Inc., El Ponce De Leon Healthcare, Inc., Arch Creek Healthcare, Inc., and Snapper Creek Healthcare, Inc. Chartwell Healthcare of Florida, Inc., issued notes to the following persons in the following amounts:

Bill H. Barbee	\$50,000
Robert D. Embrey	\$50,000
Billie J. Embrey	\$50,000
Rem Tex, Inc.	\$50,000
Martin Maris	\$50,000
Hattie Helen Phillips	\$50,000
Wendy Bracken c/o Martin and Penny Maris, Trustees	\$20,000
Ashley Bracken c/o Martin and Penny Maris, Trustees	\$20,000
Jay Gordon	\$25,000
H.A. Orgain	\$25,000
Estelle Smith	\$50,000
F.E. Brown, Jr.	\$50,000
Tyrone Davenport	\$40,000
Tyrone E. Davenport, IRA	\$10,000

Christi N. Davenport c/o Tyrone E. Davenport, Trustee	\$15,000
Melanie J. Davenport c/o Tyrone E. Davenport, Trustee	\$20,000
Travis Davenport c/o Tyrone E. Davenport, Trustee	\$15,000
Helen C. Barbee	\$50,000
Joyce Ann Davenport	\$10,000
Joyce H. Davenport, IRA	\$77,000
Davenport Enterprises, Inc.	\$10,000
Bobby Collier	\$25,000
O.L. Kimbrough	\$25,000
Sarah Elizabeth Mack c/o Edward Mack, Trustee	\$50,000
Tom W. Landers	\$3,349
Jerry Landers	\$10,000
William H. Hudspeth	\$25,000
Mack Adventure, Limited	\$50,000
Roger Moser, Sr.	\$25,000
B. Hull Barbee	\$50,000
Joost Gosschalk	\$28,349
Orval T. Lindsey, IRA	\$10,000
Pat S. Collier	\$20,000
Mike Collier	\$25,000
Curtis Collier	\$5,000
Michael Collier, Jr.	\$30,000
Clark Collier Orren	\$35,000
Joel Patrick Collier, Jr.	\$35,000

The purpose of these notes "is to provide for debt financing for the subleasing and operation of four (4) nursing home facilities located in Florida (the 'Facilities')." In each note, the corporation provided "This Note is additionally secured by an

assignment of the receivables of the Facilities up to the amount equal to the Note." Chartwell Healthcare of Florida, Inc., did not lease the nursing home facilities. Rather, each of the subsidiary corporations leased the facilities. The notes were not filed with the Secretary of State of Texas or Florida. The notes provide that Texas law governs.

There is no genuine issue of material fact that Chartwell Healthcare Services of Florida, Inc., owns the stock of Manhattan Healthcare, Inc., Holly Point Healthcare, Inc., Pensacola Healthcare, Inc., and Jupiter Healthcare, Inc. Chartwell Healthcare Services of Florida, Inc., issued notes to the following persons in the following amounts:

Michael E. Sanders	\$25,000
Bill and Betty Barbee Family Trust, Bill Barbee, Trustee	\$50,000
Carroll V. Guice	\$20,000
Helen C. Barbee	\$50,000
Bernard William Taylor	\$50,000
Michael Lee Andrews Trust	\$25,000
James W. and Bonna Lee Asbury Family Trust	\$25,000
Bobby Collier	\$25,000
O.L. Kimbrough	\$15,000
Tom and Dorothy Landers	\$25,000
The Tom and Dorothy Landers Family Trust, Tom W. Landers, III, Trustee	\$30,000
Tom W. Landers, III, and Joan S. Landers, JTWROS	\$15,000
Jerry Landers	\$10,000

Michael C. Landers and Karen C. Landers	\$15,000
Clif Cumbie	\$10,000
William H. Hudspeth	\$25,000
Joost Gosschalk	\$25,000
Jonas A. Gosschalk 1994 Trust, Joost A. Gosschalk, Trustee	\$25,000
Pat S. Collier	\$20,000
Mike Collier	\$50,000
Clark Collier Orren GP Trust, Karen Williams Collier, Trustee	\$35,000
Joel Patrick Collier, Jr. GP Trust, Allison Blair Orren, Trustee	\$35,000

Each note provides: "The purpose of the Note is to provide for debt financing for the leasing of four (4) nursing home facilities located in the state of Florida (the 'Facilities')."

In each note, the corporation provided "This note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the Note." Chartwell Healthcare Services of Florida, Inc., did not lease the nursing home facilities. Rather, each of the subsidiary corporations leased the facilities. The notes were not filed with the Secretary of State of Texas or Florida. The notes provide that Texas law governs.

There is no genuine issue of material fact that Chartwell Healthcare of Missouri, Inc., owns the stock of Mark Twain Nursing Center, Inc., Brookside Nursing Center, Inc., Oak Hill Healthcare, Inc., Lincoln Manor Nursing Center, Inc., Fredericktown Healthcare, Inc., Silex Management Co., Inc., and

Glenwood Nursing Center, Inc. Chartwell Healthcare of Missouri, Inc., issued notes to the following persons in the following amounts:

Jay Gordon	\$25,000
H.A. Orgain	\$25,000
Tyrone E. Davenport	\$48,000
Tyrone E. Davenport, IRA	\$7,870
Christie Davenport c/o Tyrone E. Davenport	\$2,000
Heather Davenport c/o Tyrone E. Davenport	\$1,600
Melanie Davenport c/o Tyrone E. Davenport	\$4,000
Travis Davenport c/o Tyrone E. Davenport	\$5,500
Joyce Ann Davenport	\$50,000
O.L. Kimbrough	\$25,000
Edward Mack	\$100,000

With the notes, the corporation executed a financing agreement which provides: "NURSING HOME does hereby give a mortgage on the receivables of the nursing homes acquired by Chartwell of Missouri, Inc. in an amount equal to 100% of the loan outstanding to the 'Lender.'" The corporation was defined in the finance agreement as the "NURSING HOME." The corporation did not acquire nursing homes. Rather, each of the subsidiary corporations acquired the nursing homes. The financing agreements were not filed with the Secretary of State of Texas or Missouri.

There is no genuine issue of material fact that Chartwell Healthcare Services of Missouri, Inc., owned the stock of Cedars Nursing Center, Inc., Ramona Villa Nursing Center, Inc., Colonial

Nursing Center, Inc., and Deerbrook Nursing Center, Inc.

Chartwell Healthcare Services of Missouri, Inc., issued notes to the following persons in the following amounts:

Bill H. Barbee	\$33,112
H.A. Orgain	\$16,557
F.E. Brown, Jr.	\$33,112
Tyrone E. Davenport	\$33,112
Heather K. Ruffin	\$16,557
Helen C. Barbee	\$16,557
Joyce Ann Davenport	\$16,557
Davenport Enterprises, Inc.	\$16,557
Bobby Collier	\$16,557
O.L. Kimbrough	\$24,835
Kelly Mack c/o Edward Mack, Trustee	\$33,112
Tom W. Landers	\$16,557
William H. Hudspeth	\$49,668
B. Hull Barbee	\$33,112
Joost Gosschalk	\$16,557
Pat S. Collier	\$16,557
Curtis Collier	\$52,980
Curtis Collier	\$6,622
Michael Collier, Jr.	\$6,621

The notes provide: "The purpose of this participating promissory note is to provide for debt financing for the subleasing and operation of four (4) nursing homes located in Kansas City, University City and St. Louis (the 'Facilities'). Maker [Chartwell Healthcare Services of Missouri, Inc.] shall

enter into long term subleases for the occupancy and operation of the Facilities with a scheduled effective date of January 1, 1996[.]” Several of the notes included a participation provision that Chartwell Healthcare Services of Missouri, Inc., “agrees to pay or cause the payment to Payee monthly payments in an amount equal to [the amount of the note divided by the total offering] of .53 of one percent (0.53%) of the gross proceeds received by Chartwell Healthcare Services of Missouri, Inc., from the Facilities[.]” The notes further provide: “This Note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the amount of the Note.” Chartwell Healthcare Services of Missouri, Inc., raised \$1,300,000 from the notes. The loan proceeds paid operating expenses including the first month’s rent of the nursing homes and the closing costs of acquiring the nursing homes. Chartwell Healthcare Services of Missouri, Inc., did not acquire the nursing homes. Rather, its subsidiaries acquired the nursing homes. The notes with the security interest were not filed with the Secretary of State of Texas or Missouri. The notes provide that Texas law governs.

There is no genuine issue of material fact that C.M., Inc., owned the stock of Platte City Nursing Center, Inc., f/k/a Chartwell of Platte City, Inc., Fayette Nursing Center, Inc., f/k/a/ Chartwell of Fayette, Inc., and Carrollton Nursing Center,

Inc., f/k/a Chartwell of Carrollton, Inc. The court has not been provided with agreements granting the Noteholders a security interest in the accounts of C.M., Inc., or any of its subsidiary corporations. Accordingly, the trustee and Heller are entitled to partial summary judgment on the accounts of C.M., Inc., and its subsidiary corporations.

There is no genuine issue of material fact that Chartwell Home Healthcare, Inc., owned some of the stock of Valley Health Group, Inc.

Chartwell Home Healthcare, Inc., issued notes to the following persons in the following amounts:

Shiloh Christian Fellowship	\$25,000
William B. Lindsey, IRA	\$50,000
Penny A. Maris	\$20,000
Wendy Bracken c/o Martin and Penny Maris, Trustees	\$10,000
Ashley Bracken c/o Martin and Penny Maris, Trustees	\$10,000
Jay Gordon	\$25,000
Bill H. Barbee	\$25,000
F.E. Brown, Jr.	\$50,000
Tyrone E. Davenport	\$80,000
Christie Davenport c/o Tyrone E. Davenport, Trustee	\$8,500
Melanie Davenport c/o Tyrone E. Davenport, Trustee	\$12,900
Travis Davenport c/o Tyrone E. Davenport, Trustee	\$3,100
Helen C. Barbee	\$50,000
James W. and Bonna Lee Asbury Family Trust	\$75,000
Joyce Ann Davenport	\$10,000
Hoyle Oil & Mineral, Inc.	\$20,000

Bobby Collier	\$25,000
O.L. Kimbrough	\$25,000
Edward Mack	\$50,000
Tom W. Landers	\$25,000
Tom and Dorothy Landers Family Trust, Tom W. Landers III, Trustee	\$25,000
Tom W. Landers, III and Joan S. Landers, JTWROS	\$10,000
Jerry Landers	\$10,000
William H. Hudspeth	\$55,000
William H. Hudspeth	\$55,000
Roger Moser, Sr.	\$10,000
B. Hull Barbee	\$25,000
Orval T. Lindsey	\$16,400
Orval T. Lindsey, IRA	\$8,600
Pat S. Collier	\$25,000
Mike Collier	\$25,000
Clark Collier Orren c/o Karen Williams Collier, Trustee	\$25,000
Joel Patrick Collier, Jr. c/o Alison Blair Collier Orren, Trustee	\$25,000
James M. and Penelope L. Hill, JTWROS	\$25,000
W.M. Matthews, Jr.	\$50,000

Each note included an "Additional Security" clause by which the corporation granted "an assignment of the receivables of the Facilities up to the amount equal to the Note." The purpose of each Note was "to provide for debt financing for the acquisition of 70% of the stock of Valley Health Group, Inc[.]" Valley Health Group, Inc., is a debtor in a bankruptcy case pending in the District of Arizona.

Rights in the Collateral

The trustee contends that, except for East Texas Healthcare I, Inc., and East Texas Healthcare II, Inc., none of the corporations that generated accounts granted the Noteholders a security interest in the accounts receivable. As codified in Texas, Florida and Missouri, section 9.203(a) of the Uniform Commercial Code provides, in pertinent part

[A] security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

- (1) the collateral is in the possession of the secured party pursuant to agreement or the debtor has signed a security agreement which contains a description of the collateral[;]
- (2) value has been given; and
- (3) the debtor has rights in the collateral.

Tex. Bus. & Com. Code §9.203(a).

East Texas Healthcare, Inc., Chartwell Healthcare of Florida, Inc., Chartwell Healthcare Services of Florida, Inc., Chartwell Healthcare of Missouri, Inc., Chartwell Healthcare Services of Missouri, Inc., and Chartwell Home Healthcare, Inc., signed security agreements with the respective noteholders, as described above, which contain a description of the collateral. The respective noteholders gave value for each security agreement. But the subsidiary corporations of these debtors owned the collateral.

Nevertheless, the Noteholders, invoking the doctrine of rights in the collateral, contend that the debtors who signed the security agreements had control over the subsidiaries' collateral sufficient to convey a security interest, thereby satisfying the third requirement of §9.203(a).

The court must honor the separate legal existence of the corporate entities, absent fraud or abuse of the corporate form. See Matter of Sims, 994 F.2d 210, 215-16 (5th Cir. 1993).

Nevertheless, a debtor may grant a security interest in assets even if it does not hold legal title if the debtor has sufficient "rights in the collateral." See In re Whatley, 874 F.2d 997, 1004 (5th Cir. 1989). The Noteholders assert that there is an issue of material fact as to whether the parent corporations had sufficient "rights in the collateral" based on consent, 874 F.2d at 1004, or estoppel to pledge the receivables of the nursing home subsidiary corporations.

A debtor who does not own an asset may nonetheless use the asset as security, thereby acquiring "rights in the collateral," when authorized to do so by the actual owner of the collateral. See, e.g., Bevans v. Stuart, No. CV990588768, 2001 WL 617191, at *2 (Conn. Super. Ct. May 14, 2001). In other words, an owner's consent to the use of its assets as collateral creates rights in the debtor sufficient to give rise to an enforceable security interest. See id.; In re Atchison, 832 F.2d 1236, 1239 (11th

Cir. 1987); In re Pubs, Inc. of Champaign, 618 F.2d 432, 436 (7th Cir. 1980). An enforceable security interest may also arise where the "true owner has become estopped to deny the creation or existence of the security interest." In re Pubs, 618 F.2d at 436.

The Noteholders have presented summary judgment evidence that Irving D. Boyes had been the sole director and president of the Chartwell subsidiaries. The nursing home subsidiaries relinquished control of their revenues to their respective parent corporation which, in turn, centralized funds, and paid expenses. From this summary judgment evidence, the Noteholders contend that Boyes could cause the nursing home subsidiary corporations to consent to pledge their nursing home receivables in order to obtain financing utilized by each corporation to acquire the operating leases which generated the receivables. The Noteholders further argue that, as a consequence, the debtors, both parent and subsidiary corporations, would be estopped from asserting that the parent corporations did not have rights in the collateral.

Neither Heller nor the trustee have presented any evidence to counter the Noteholders' summary judgment evidence. Therefore, the Noteholders' evidence contrasted with the evidence of separate corporations presents a genuine issue of material fact on the issue of whether the parent corporations had

sufficient rights in the receivables of the subsidiary nursing home corporations which would enable the parent corporations to pledge these receivables to the Noteholders as security.

Filing Exception

Heller contends that the none of the noteholders filed their financing statements and therefore do not hold a perfected lien, let alone a lien senior in priority to Heller's liens. The Noteholders respond that under §9.302(a)(5) of the Uniform Commercial Code they did not need to file their financing statements to perfect their security interests.

As a general proposition, to perfect a security interest, the creditor must file its UCC financing statement in the appropriate place. See, e.g., Tex. Bus. & Com. Code §9.203(a) and (b). However, §9.302(a)(5) of the Uniform Commercial Code provides: "(a) A financing statement must be filed to perfect all security interests except the following: (5) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor." Tex. Bus. & Com. Code §9.302(a)(5).

With some justification based on the case law, the parties disagree on the application of this filing exemption. The Official Comment to the section states:

The purpose of the [UCC §9.302(a)(5)] exemption is to save from ex post facto invalidation casual or

isolated assignments: some accounts receivable statutes were so broadly drafted that all assignments, whatever their character or purpose, fell within their filing provisions. Under such statutes many assignments which no one would think of filing might have been subject to invalidation. The [UCC §9.302(a)(5)] exemption goes to that type of assignment. Any person who regularly takes assignments of any debtor's accounts should file.

Tex. Bus. & Com. Code §9.302, Official Comment.

"Significant part"

In Abramson v. Printer's Bindery, Inc., 440 S.W.2d 326 (Tex. Civ. App.-Dallas 1969), the Texas Court of Appeals stated that "[t]he transfer of the accounts in this case may be characterized as casual or isolated." 440 S.W.2d at 328. Based on that statement, the Noteholders contend that Texas courts apply the exemption by determining whether the transfer of the security interest in the accounts was "casual or isolated." But that reading supplants the plain language of the statute with the uncodified commentary. The Texas Court of Appeals did not purport to nor did it state that it intended to rewrite the statute.

Accordingly, in In re Klein Glass & Mirror, Inc., 155 B.R. 718 (Bankr. S.D. Tex. 1992), the court reasoned that the "casual and isolated" analysis cannot supplant the "substantial part" percentage test of the statute. Because that percentage test can be ambiguous, the court could consider the "casual and isolated" analysis as an independent or additional test. 155 B.R. at 722. But "[a]t the very least the statute requires that a financing

statement be filed if the assignment of accounts is a substantial portion of the debtor's accounts receivable." Id. Heller argues thereupon that the Noteholders must establish that they did not receive a substantial portion of the accounts and that the transaction was casual and isolated. But requiring two tests, when the statute codifies but one, also rewrites the statute.

The courts have had a difficult time articulating how they have applied the commentary to the Code. The court must begin with the language of the statute. The statute requires that the court determine if the debtor assigned to an assignee a significant part of the outstanding accounts of the assignor. If the court can conclude that the debtor did transfer a significant part of its outstanding accounts to an assignee, the filing exemption does not apply. If the court can conclude that the debtor did not transfer a significant part of its outstanding accounts to an assignee, the filing exemption does apply.

But the Uniform Commercial Code does not define "significant part." Abramson, 440 S.W.2d at 328; Barkley Clark, The Law of Secured Transactions Under the Uniform Commercial Code, §2.7[6] (2d ed. 1988). Consequently, within the paradigm of certainly significant and certainly insignificant, the court will confront a grey area in which it must determine what constitutes a significant part. In that area, the court must draw a legal conclusion from the facts and circumstances of the transaction.

To guide the court, the court may consider the commentary to the Uniform Commercial Code, to assess the drafters' intent in codifying the filing exemption. That is what the cases teach. See Clark, at §2.7[6].

In Abramson, the Texas Court of Appeals, adjudicating a preference action, had to determine the meaning of "significant part" on an ambiguous appellate record. The trial court made a finding of fact that the plaintiff failed to establish that a significant part of the outstanding accounts had been transferred to the assignee. 440 S.W.2d at 328. On appeal, the plaintiff contended the trial court erred in making that finding. The plaintiff had attempted to establish that the filing exemption did not apply. The debtor transferred about \$6,300 face value of accounts in one month, but the debtor typically had \$10,000 worth of accounts monthly. 440 S.W.2d at 327. Consequently, if the outstanding accounts of the assignor consisted of that single month, the debtor transferred 63% of its accounts to the assignee. But if the outstanding accounts consisted of an annualized sum, the debtor transferred only 5.25% of its accounts to the assignee. The Texas Court of Appeals noted that the statute did not define the phrase "significant part." 440 S.W.2d at 328. Considering that the percentage of accounts transferred differed depending on the actual outstanding accounts, which amount was not clear on the trial court record, and the lack of a

statutory definition, the court turned to the commentary for guidance in applying the standard. The court analyzed that the transfer was casual and isolated. Since the transfer was casual and isolated, the court in effect then determined that the focus on the evidence should not be limited to one month's worth of accounts. Since the trial court record contained evidence that the outstanding accounts could have totaled significantly more than the one month figure, the court held that the trial court did not err in its finding that the plaintiff failed to establish that a significant part of the accounts had been transferred.

Id.

Thereafter, the bankruptcy court in In re First City Mortgage Co., 69 B.R. 765 (Bankr. N.D. Tex. 1986), cited Abramson in its analysis of the exemption. The First City Mortgage court observed that "[t]here is nothing 'casual or isolated' about the transfer at issue here," 69 B.R. at 768, but did not thereby convert the statutory language of "significant part" into a test of "casual or isolated." RepublicBank, then the largest lending institution in the State of Texas, obtained an assignment of "all or nearly all of the mortgage servicing income of the debtor." 69 B.R. at 766. A transfer of all or nearly all accounts is a significant part of the accounts, obviously. The court therefore merely noted there was nothing else to consider. RepublicBank,

which had not filed the assignment, could not perfect by the filing exemption. 69 B.R. at 768.

In Klein Glass, the bankruptcy court also concluded that the debtor assigned a substantial part of its accounts to the assignee, thereby precluding the application of the filing exception. The debtor assigned 40% of its outstanding accounts to the assignee. 155 B.R. at 720. The court applied the language of the statute and concluded that 40% constituted a significant part of the accounts. 155 B.R. at 721. The court then addressed whether Texas supplanted the statutory language with the "casual or isolated" discussion of the commentary. The court concluded that the Texas court merely made its observations in attempting to assess the record on appeal. The court then reasoned that under the facts and circumstances of a given case, the statutory standard of "significant part" may be ambiguous and undefined. 155 B.R. at 721. In that circumstance, the court should be guided by the drafters' comments as well as learned treatises and other appropriate legal analysis. Holding that an assignment of 40% of the debtor's outstanding accounts is a significant part of the accounts, the court found no need to analyze factors that would be employed under more ambiguous circumstances. 155 B.R. at 722.

Accordingly, this court analyzes the summary judgment evidence to determine if there is a genuine issue of material

fact concerning the percentage of the outstanding accounts of an assignor assigned to an assignee. The court then determines if the percentage is a "significant part" of the outstanding accounts of the assignor. If the court concludes that from the percentage alone it cannot determine if the assignment is a "significant part," then the court assesses the examples discussed in the commentary as well as the decisions of prior cases to determine the significance of the assignment.

"Outstanding Accounts"

The parties' statutory construction argument does not address the requirement that the assignment cannot be a significant part "of the outstanding accounts of the assignor[.]" §9.302(a)(5). The Uniform Commercial Code does not define "outstanding." But "outstanding" commonly means "uncollected, unpaid." Webster's Third New Int'l Dictionary 1604 (1986).

Each of the financing agreements summarized above, whether included in the notes or in a separate document, granted a security interest in accounts to be generated by nursing home facilities to be acquired, in part, with the proceeds raised by the notes. The filing exemption does not address the grant of a security interest in future acquired accounts, but rather addresses a security interest in outstanding accounts. Compare Tex. Bus. & Com. Code §9.302(a)(5) (addressing "outstanding accounts"), with Tex. Bus. & Com. Code §9.204(a) (establishing

that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."). Accordingly, the exemption may not apply to these transactions. The Code's notion that the assignment of an insignificant part of outstanding accounts to an assignee need not be filed to perfect the assignee's security interest may have no application to an ongoing grant of a security interest in future acquired accounts extending in time until a note is paid. Since the parties have not addressed the issue, the court will defer further consideration. The court will provide the parties with an opportunity to brief the issue.

The assignors may, however, have had outstanding accounts at the time they granted the security interest in accounts. If so, the court would engage in the calculations described above. But the court lacks summary judgment evidence of the outstanding accounts of each of the assignors at the time of the execution of the notes and financing agreements summarized above. The court therefore cannot determine whether a significant part of the outstanding accounts had been assigned to each assignee at the time of the execution of the security agreement.

The Noteholders have requested an opportunity for further discovery pursuant to Fed. R. Civ. P. 56(f). Presumably, that discovery may reveal whether the assignors had outstanding receivables at the time of the granting of the security interest,

and, if so, the amount. The court will grant limited discovery concerning accounts of each assignor at the time of the execution of the notes and, where applicable, the separate financing agreement.

Illustrative Applications

The Noteholders have provided summary judgment evidence of outstanding accounts at specific times after the granting of a security interest. That summary judgment evidence is drawn, in part, from evidence from the trustee. Heller produced evidence of different amounts of outstanding accounts at different times. For illustrative purposes, the court engages in the exercise of applying the filing exemption to the outstanding accounts on dates supported by the Noteholders' summary judgment evidence. The exercise should aid the parties' understanding of how the court reads and applies the filing exemption statute.

East Texas Healthcare I, Inc.

This assignor assigned accounts by a formula. The formula reads: "Nursing Home does hereby give a first mortgage on [the amount of the note divided by the total offering] of seventy-five percent (75%) of the receivables of the nursing homes under lease to East Texas Healthcare I, Inc." The total amount of the offering was \$800,000. Accordingly, to determine the assignment, the court divides the amount of the note by \$800,000 and multiplies that figure by 00.75. The result yields the

percentage of the accounts assigned to an assignee. With this formula, the court need not determine the amount of outstanding accounts of the assignor. The formula determines the percentage of those accounts, whatever the number, assigned to an assignee.

And yet, if East Texas Healthcare I, Inc., had no accounts outstanding at the time it granted the security interest, the filing exemption may be inapplicable, an issue deferred for subsequent consideration.

As found above, O.L. Kimbrough held three notes totaling \$75,500. He had the highest pledge of accounts. Applying the formula, the assignor assigned 7.08% of its outstanding accounts to Kimbrough, assuming outstanding accounts existed. At the other end, Christie Davenport and Melanie Davenport each held \$4,000 notes, care of their father, as trustee. Applying the formula, the assignor assigned 0.4% of its outstanding accounts to each of them, assuming outstanding accounts existed.

These would not amount to an assignment to an assignee of a significant part of the outstanding accounts of the assignor, assuming outstanding accounts existed.

East Texas Healthcare II, Inc.

This assignor also assigned accounts by a formula. The formula reads: "Nursing Home does hereby give a first mortgage on [the amount of the note divided by the total offering] of seventy-five percent (75%) of the receivables of the nursing

homes under lease to East Texas Healthcare II, Inc.” The total amount of the offering was \$1,200,000. To determine the assignment, the court divides the amount of the note by \$1,200,000 and multiplies that figure by 00.75. The result yields the percentage of accounts assigned to an assignee. With this formula the court need not determine the amount of the outstanding accounts. The formula determines the percentage of those accounts, whatever the number, assigned to the assignee.

Again, if East Texas Healthcare II, Inc., had no accounts outstanding when it granted the security interests, the filing exemption may be inapplicable, an issue deferred for subsequent consideration.

As found above, Edward Mack was the assignee with the largest note amount, \$50,000. Applying the formula, the assignor assigned 3.13% of its outstanding accounts to Mack, assuming outstanding accounts existed. At the other end, several individual assignees held \$25,000 notes, which, applying the formula, results in 1.56% of outstanding accounts, assuming outstanding accounts existed.

These would not amount to an assignment to an assignee of a significant part of the outstanding accounts of the assignor, assuming outstanding accounts existed.

East Texas Healthcare, Inc.

This assignor assigned accounts by a formula. The formula reads: "Nursing Home does hereby give a first mortgage on [the amount of the note divided by the total offering] of seventy-five percent (75%) of the receivables of the nursing homes under lease to East Texas Healthcare, Inc." The total amount of the offering was \$2,000,000. Accordingly, to determine the assignment, the court divides the amount of the note by \$2,000,000 and multiplies that figure by 00.75. The result yields the percentage of the accounts assigned to an assignee. With this formula, the court need not determine the amount of outstanding accounts of the assignor. The formula determines the percentage of those accounts, whatever the number, assigned to an assignee.

And yet, if East Texas Healthcare, Inc., had no accounts outstanding at the time it granted the security interest, the filing exemption may be inapplicable, an issue deferred for subsequent consideration.

As found above, Edward Mack was the assignee with the largest note, \$100,000. Applying the formula, the assignor assigned 3.75% of its outstanding accounts to Mack, assuming outstanding accounts existed. At the other end, O.L. Kimbrough held a \$10,000 note, which, applying the formula, results in 0.38% of outstanding accounts, assuming outstanding accounts existed.

These would not amount to an assignment to an assignee of a significant part of the outstanding accounts of the assignor, assuming outstanding accounts existed.

Chartwell Healthcare of Florida, Inc.

This assignor assigned accounts as follows: "This Note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the Note." Heller contends that this amounts to an assignment of 100% of the accounts. It does not. It only assigns up to the amount of the note. To determine the percentage, the court must determine the outstanding accounts of the assignor and then divide the amount of the note by the amount of the outstanding accounts.

The Noteholders have presented summary judgment evidence that the amount of the outstanding accounts on June 30, 1998, was \$1,482,081.99. Heller has presented summary judgment evidence of a different amount on a different date. The assignment occurred at various dates in March 1996. The court does not have summary judgment evidence of the outstanding accounts at that time. The assignor issued the notes to raise capital to purchase nursing homes to generate accounts; presumably, it had no accounts outstanding when it conveyed the security interest in accounts. Deferring the issue of outstanding accounts in March 1996 and the applicability of the filing exemption to future acquired accounts, the court considers the summary judgment evidence of

the outstanding accounts of \$1,482,081.99, on June 30, 1998, for illustrative purposes of a high/low analysis.

Using that figure, the largest note of an individual assignee was \$50,000 of which there were several. The lowest note, held by Tom W. Landers, was \$3,349. The assignees with the \$50,000 notes, held 3.4% of that figure. Landers, 0.23%.

If the court determines that the outstanding accounts on June 30, 1998, should be used, then these would not amount to an assignment of a significant part of the accounts of the assignor.

Chartwell Healthcare Services of Florida, Inc.

This assignor assigned accounts as follows: "This Note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the Note." Heller contends that this amounts to an assignment of 100% of the accounts. It does not. It only assigns up to the amount of the note. To determine the percentage, the court must determine the outstanding accounts of the assignor and then divide the amount of the note by the amount of the outstanding accounts.

The Noteholders have presented summary judgment evidence that the amount of the outstanding accounts on June 30, 1998, was \$5,016,430. Heller has presented summary judgment evidence of a different amount on a different date. The notes issued by Chartwell Healthcare Services of Florida, Inc. are not dated. The Noteholders' affidavits suggest that the assignor executed

the security interest sometime after July or August 1997. The summary judgment evidence does not establish the date of execution. Whatever that date, the court must determine if the assignor had accounts outstanding and, if so, how much. The court does not have summary judgment evidence of the outstanding accounts at that time. The assignor issued the notes to raise capital to purchase nursing homes to generate accounts; presumably, it had no accounts outstanding when it conveyed the security interest in accounts. Deferring the issue of outstanding accounts on or after July of 1997 and the applicability of the filing exemption to future acquired accounts, the court considers the summary judgment evidence of outstanding accounts of \$5,016,430, on June 30, 1998, for illustrative purposes of a high/low analysis.

Using that figure, the largest note of an individual assignee was \$50,000, of which there were several. The lowest note, \$10,000. The assignees with the \$50,000 notes, held 0.99% of that figure. The \$10,000 notes, 0.2%.

If the court determines that the outstanding accounts on June 30, 1998, should be used, then these would not amount to an assignment of a significant part of the accounts of the assignor.

Chartwell Healthcare of Missouri, Inc.

This assignor assigned accounts as follows: "Nursing Home does hereby give a mortgage on the receivables of the nursing

homes acquired by Chartwell of Missouri, Inc. in an amount equal to 100% of the loan outstanding to the 'Lender'." To determine the percentage, the court must determine the outstanding accounts of the assignor and then divide the amount of the note by the amount of the outstanding accounts.

The Noteholders have presented summary judgment evidence that the amount of the outstanding accounts on June 30, 1998, was \$2,064,974.97. Heller has presented summary judgment evidence of a different amount on a different date. The assignment occurred at various dates in November 1994. The court must determine if the assignor had accounts outstanding and, if so, how much. The court does not have summary judgment evidence of the outstanding accounts at that time. The assignor issued the notes to raise capital to purchase nursing homes to generate accounts; presumably, it had no accounts outstanding when it conveyed the security interest in accounts. Deferring the issue of outstanding accounts on November 1994 and the applicability of the filing exemption to future acquired accounts, the court considers the summary judgment evidence of outstanding accounts of \$2,064,974.97, on June 30, 1998, for illustrative purposes of a high/low analysis.

Using that figure, Edward Mack was the assignee with the largest note, \$100,000. Applying the formula, the assignor assigned 4.8% of its outstanding accounts to Mack. At the other

end, Heather Davenport held a \$1,600 note, which, applying the formula, results in a negligible part.

If the court determine that the outstanding accounts on June 30, 1998, should be used, then these would not amount to an assignment of a significant part of the accounts of the assignor.

Chartwell Healthcare Services of Missouri, Inc.

This assignor assigned accounts as follows: "This Note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the amount of the Note." To determine the percentage, the court must determine the outstanding accounts of the assignor and then divide the amount of the note by the amount of the outstanding accounts.

The Noteholders have presented summary judgment evidence that the amount of the outstanding accounts on June 30, 1998, was \$1,834,628. Heller presented summary judgment evidence of a different amount on a different date. The assignment occurred at various dates in January 1996. The court does not have summary judgment evidence of the outstanding accounts at that time. The assignor issued the notes to raise capital to purchase nursing homes to generate accounts; presumably, it had no accounts outstanding when it conveyed the security interest in accounts. Deferring the issue of outstanding accounts in January 1996 and the applicability of the filing exemption to future acquired accounts, the court considers the summary judgment evidence of

outstanding accounts of \$1,834,628, on June 30, 1998, for illustrative purposes of a high/low analysis.

Using that figure, Curtis Collier held two notes totaling \$59,602. He had the highest pledge of accounts. Applying the formula, the assignor assigned 3.2% of its outstanding accounts to Collier. At the other end, Michael Collier, Jr., held a \$6,621 note, which results in 00.36%.

If the court determines that the outstanding accounts on June 30, 1998, should be used, then these would not amount to an assignment of a significant part of the accounts of the assignor.

Chartwell Home Healthcare, Inc.

This assignor assigned accounts as follows: "This Note is additionally secured by an assignment of the receivables of the Facilities up to the amount equal to the Note." To determine the percentage, the court must determine the outstanding accounts of the assignor and then divide the amount of the note by the amount of the outstanding accounts.

The Noteholders have presented summary judgment evidence that the amount of the outstanding accounts on November 30, 1997 was \$10,098,947 and was \$11,811,099 on June 23, 1998. The notes issued by Chartwell Home Healthcare, Inc. are not dated. The Noteholders' affidavits suggest that the assignor executed the security interest sometime after May 15, 1997. The summary judgment evidence does not establish the date of execution. The

court does not have summary judgment evidence of the outstanding accounts at that time. The assignor issued the notes to raise capital to purchase the stock of Valley Health Group, Inc. which was then operating in California, Arizona, Nevada, and Colorado. Presumably, Valley Health Group, Inc. had accounts outstanding when Chartwell Home Healthcare, Inc. conveyed the security interest in accounts. Valley's bankruptcy case may stay this court's determination of the issue. Nevertheless, deferring the issues of the stay, of outstanding accounts in May 1997 and the applicability of the filing exemption to future acquired accounts, the court considers the summary judgment evidence of outstanding accounts of \$10,098,947 on November 30, 1997, and \$11,811,099 on June 23, 1998, for illustrative purposes.

Using the lower figure, William H. Hudspeth held two notes, totaling \$110,000, making him the largest assignee. Applying the formula, the assignor assigned 1.0% of its outstanding accounts to Hudspeth. One of Tyrone Davenport's children, Travis, had the smallest note, \$3,100, which, applying the formula, resulted in a negligible part.

If the court determines that the outstanding accounts on November 1997 should be used, then these would not amount to an assignment of a significant part of the accounts of the assignor.

Summary

There are genuine issues of material fact of whether the

assignors had rights in the collateral of their respective subsidiary corporations to pledge the accounts of the subsidiary corporations to the Noteholders. The court, therefore, cannot determine on summary judgment that the requirements of §9.203(a) of the Uniform Commercial Code have been established. The court will defer entry of an order denying the summary judgment requests on this issue until completion of the court's consideration of the remaining issues.

There is no genuine issue of material fact that none of the financing statements had been filed. The Noteholders contend that the financing statements need not be filed to be perfected because of §9.302(a)(5). However, the summary judgment evidence does not establish whether any of the assignors or their respective subsidiaries had outstanding accounts when they granted the security interest in accounts. If they had no outstanding accounts, the court must determine whether the filing exemption applies. If they had accounts on that date, the court must determine the amount of the outstanding accounts and then apply the filing exemption statute as explained and illustrated in this memorandum opinion.

There is no genuine issue of material fact of the percentage of accounts assigned by East Texas Healthcare I, Inc., East Texas Healthcare II, Inc., and East Texas Healthcare, Inc., if they had outstanding accounts to pledge.

Orders

Based on the foregoing,

IT IS ORDERED that the parties shall arrange for mutual discovery concerning the amount of outstanding accounts of each assignor corporation and their respective subsidiary corporations on the date of the granting of the security interest to the Noteholders in accounts. The discovery shall be completed within 30 days from the date of service of this order.

IT IS FURTHER ORDERED that the parties shall file supplemental summary judgment motion papers with summary judgment evidence addressing the issues deferred in the above memorandum opinion as follows: The Noteholders shall serve and file their supplement within 45 days from the date of service of this order. The trustee and Heller shall serve and file their responses within 15 days of service of the Noteholders supplemental papers. The Noteholders may serve and file a reply within 15 days of service of the responses.

Signed this _____ day of June, 2001.

Steven A. Felsenthal
United States Bankruptcy Judge