IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
HOT SPRINGS DIVISION

IN RE: ALLIANCE INSURANCE GROUP OF ARKADELPHIA, INC., Debtor

No. 6:18-bk-71472
Ch. 7

ORDER DENYING MOTION TO ABANDON

Before the Court is the Bank of Prescott's *Motion to Abandon*, filed on January 2, 2019; Southern Bancorp Bank's response filed on January 7, 2019, in support of the Bank of Prescott's motion; the chapter 7 trustee's *Trustee's Response to Motion to Abandon Filed by Bank of Prescott [Dkt. No. 76] and Response (Joinder) by Southern Bancorp [Dkt. No. 81]*, filed on January 10, 2019; and the Bank of Prescott's reply to the trustee's response filed on January 14, 2019. The Court held a trial on January 16, 2019, and at the conclusion of the trial, gave the parties until January 28, 2019, to file any post-trial briefs. Both the trustee and the Bank of Prescott filed their post-trial briefs timely. For the reasons stated below, the Court denies the Bank of Prescott's *Motion to Abandon*.

The ultimate issue before the Court is whether the security agreements between the debtor and, respectively, the Bank of Prescott [the Bank] and Southern Bancorp Bank [Southern] were sufficient to give the banks liens against any potential commercial tort claims the debtor or trustee may now have in the debtor's bankruptcy case against third parties. The secondary issue before the Court, if the Court finds that the potential commercial tort claims remain property of the estate, is whether the Court should order the trustee to abandon those commercial tort claims under 11 U.S.C. § 554. The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(A). The following opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052, made applicable to this proceeding under Federal Rule of Bankruptcy Procedure 9014.

History of the Case

The Bank is asking the Court to require the trustee to abandon the estate's interest in property consisting of twenty-one promissory notes and related security agreements totaling approximately $1.5 million that the debtor executed. In its motion, the Bank states that the notes–referred to as "the Collateral" in its motion–are burdensome to the estate and of inconsequential value and benefit to the estate. In July 2018, the Bank was granted relief from the automatic stay to pursue its lawful remedies against the Collateral. Between July 2018 and January 2019 (when the Bank filed its motion to abandon), the Bank negotiated a sale of the Collateral to a third-party insurance agency. An apparent condition of the sale was that the Collateral included "all claims and interests related to the Collateral." The Bank believes this language includes any potential commercial tort claims the debtor may have against third parties, including the third-party insurance agency.[1]

Southern is in a similar situation and has filed its response in support of the Bank's motion to abandon. The debtor executed nine promissory notes and related security agreements totaling approximately $1.0 million in favor of Southern. According to Southern, its collateral is substantially the same property as the Collateral described by the Bank in its motion to abandon. Southern was also granted relief from the automatic stay to pursue its claims against its collateral and is also a party to the proposed sale to the third-party insurance agency with the condition that the sale include "all claims and interests related to the Collateral." Southern, too, believes this language includes any potential commercial tort claims the debtor may have against third parties, including the third-party insurance agency.

[1] The broad language of "all claims and interests related to the Collateral" may also arguably encompass all of the trustee's avoidance powers under chapter 5 of the code, further limiting the trustee's fiduciary duty to the debtor's unsecured creditors.

Position of the Parties

The Bank and Southern both argue that the language included in their respective security agreements with the debtor encompasses any claims and interests in such a way that the banks would have a security interest in *any* causes of action related to the security agreements. As an example, the Bank referenced "Proceeds Claims" in its reply to the trustee's response that included causes of action listed by the debtor in its petition: tortuous interference with contractual relationship and conversion. According to the Bank, the "Proceeds Claims are based on claims that third parties converted and interfered with" the debtor's book of business, also known as referrals. Both banks believe that because the debts to the Bank and Southern exceed the value of the Collateral, the Collateral, including any claims and interests related to the Collateral, are of inconsequential value and benefit to the estate and the Court should order the trustee to abandon the claims from the estate. Apparently, the proposed sale of the debtor's book of business is dependent upon the sale also including any potential commercial tort claims the debtor, and now the trustee, may have against the purchasers.

The trustee is concerned with the broad language that is included in both the Bank's motion to abandon and the proposed release "from any and all claims, actions, causes of action, suits" that was to be executed by the trustee and included in the proposed sale documents between the Bank, Southern, and the third-party insurance agency–the purchaser of the referrals. The trustee argues that the security agreements did not create a lien on any commercial tort claims, including those listed by the debtor in its petition, because the claims were not identified with specificity in the security agreements. According to the trustee, the right to pursue a commercial tort claim is distinct from the right to pursue the proceeds from a commercial tort claim, which is an issue that is not before the Court because, to date, there are no proceeds from a commercial tort claim. Because the commercial tort claims were not identified in the security agreements, the trustee argues that the right to pursue the commercial tort claims remains with the trustee.

Findings of Fact and Conclusions of Law

State law determines the "'nature and extent of a party's property interest for the purposes of Code provisions.'" *In re Ausburn*, 524 B.R. 816, 819 (Bankr. E.D. Ark. 2015), quoting *Schinck v. Stephens* (*In re Stephens*), 221 B.R 290, 292 (Bankr. D. Me. 1998). Under Arkansas law, a commercial tort claim is defined as "a claim arising in tort with respect to which: (A) the claimant is an organization . . . ." Ark. Code Ann. § 4-9-102 (Supp. 2017). The claimant in this case is the debtor, Alliance, an organization. Upon the filing of the debtor's voluntary petition, all of the debtor's legal and equitable interests in property, including any causes of action and commercial tort claims, became property of the estate and subject to the control of the trustee. 11 U.S.C. §§ 541, 704; *In re Ozark Rest. Equip. Co.*, 816 F.2d 1222, 1225 (8th Cir. 1987).

The banks argue that even if the tort claims became property of the estate upon filing, the potential claims and interests related to the Collateral are subject to the banks' respective security agreements under either their after-acquired general intangible clauses, their after-acquired proceeds clauses, or any other clauses that may be read broadly enough to include the potential claims and interests. As such, the banks contend that the claims are of inconsequential value and benefit to the estate. However, the law regarding the creation of a security interest in a commercial tort claim requires more than a description only by the type of collateral. Ark. Code Ann. § 4-9-108(e). This is explained with detail and clarity in a case that all parties submitted to the Court in support of their respective positions: *Bayer CropScience, LLC v. Stearns Bank Nat'l Ass'n* (*In re Bayer CropScience*), 837 F.3d 911 (8th Cir. 2016) (discussing commercial tort claim requirements under identical Texas law); *see also In re American Cartage, Inc.*, 656 F.3d 82 (1st Cir. 2011) (same under Massachusetts law).

In *Bayer CropScience*, the Eighth Circuit, citing to the Texas UCC, stated,

> the UCC imposes heightened identification requirements to encumber commercial tort claims, *see id*. § 9.108(e) and cmt. 5 ("Subsection (e) requires that a description by defined 'type' of collateral alone of a commercial tort claim ... is not sufficient."). The UCC imposes this

> heightened description requirement "in order to prevent debtors from inadvertently encumbering" commercial tort claims. *See id.* § 9.108 cmt. 5. Further, the UCC states "that when an effective security agreement covering a commercial tort claim is entered into the claim already will exist" as of the time of the effective date of the security agreement. *See id.*; *see also id.* § 9.204 cmt. 4 ("In order for a security interest in a tort claim to attach, the claim must be in existence when the security agreement is authenticated.").

Bayer CropScience, 837 F.3d at 916. Because the tort claims that are at issue in this case were not specifically described in the parties' security agreements and, in fact, did not even exist at the time the security agreements were entered into, the Court finds that the banks' respective security agreements do not encompass the commercial tort claims that are at issue in this case. All commercial tort claims that existed when the debtor filed his voluntary petition remain property of the debtor's estate.

Which brings the Court to the second issue: whether the Court should order the trustee to abandon the commercial tort claims as requested by the banks. Section 554(b) of the code states that "the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." In this instance, the Court finds that the commercial tort claims are not burdensome to the estate. The Court entered its order granting the trustee's application to employ outside counsel to advise the trustee and investigate, file, and prosecute "causes of action, including in connection with the management and operation of the Debtor's insurance premium trust account by the Debtor's officers, directors, employees and agents." In other words, to investigate, file, and prosecute the trustee's commercial tort claims. The outside counsel has agreed to advance all litigation expenses, which relieves the estate from what could have been a substantial financial burden. Finally, the employment agreement provides for the payment of legal fees on a contingent fee basis that is entirely dependent upon any recovery from litigation. For these reasons, the Court finds that the commercial tort claims are not burdensome to the estate.

However, § 554 is written in the disjunctive. Even if the Court finds the claims are not

burdensome to the estate, it may find that the commercial tort claims are of inconsequential value and benefit to the estate. In support of this prong, the banks introduced evidence and testimony that the debt owed to the banks far exceeds the value of the Collateral such that even after prosecution of the tort claims, the proceeds from the tort claims would more than likely not be sufficient to pay the banks' secured claims in full. This argument presupposes that any recovery the trustee obtains from the commercial tort claims would inure to the benefit of the banks either because of their respective liens on the proceeds of the commercial tort claims or based on their respective after-acquired general intangibles clauses in the security agreements.

The Court will address the banks' arguments only as they relate to the banks' beliefs that the commercial tort claims are of inconsequential value and benefit to the estate. First, according to the Eighth Circuit, because the drafters of the UCC included heightened requirements for the identity of commercial tort claims, any proceeds from a commercial tort claim would be excluded from a security agreement's broadly written after-acquired general intangibles clause as well. *Bayer CropScience*, 837 F.3d at 916. As a result, any of the banks' arguments that their respective security interests should attach to the proceeds under an after-acquired general intangibles clause would have to fail.

Similarly, the banks' reliance on their respective security agreements to attach the proceeds recovered from a commercial tort claim is overly broad. As quoted in the Bank's post-trial brief: "a superior interest in proceeds of original collateral is not displaced simply because damage to that collateral gives rise to a subsequent commercial tort claim." *Bayer CropScience*, 837 F.3d at 916. What the Bank fails to recognize is the proceeds that are being referred to in *BayerScience* would be proceeds that would return value to the creditor for damage to its original collateral. *Id., see also In re American Cartage, Inc.*, 656 at 89. It is not clear to the Court at this time whether a commercial tort claim for, e.g., tortuous interference with contractual relationship or conversion would necessarily be related to damage to the original collateral. If it is not related, the value and benefit to the estate of any recovery is far from inconsequential. And if a

recovery does relate to damage to the original collateral, the recovery may exceed the alleged damage. For these reasons, the Court finds that the commercial tort claims are not of inconsequential value and benefit to the estate.

Accordingly, the Court denies the Bank's and Southern Bancorp's motion to abandon the commercial tort claims from the debtor's estate.

IT IS SO ORDERED.

Ben Barry
United States Bankruptcy Judge
Dated: 02/12/2019

cc: M. Randy Rice
Kathryn G. Reid
Paul T. Bennett
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