

MEMORANDUM

To: Jane Doe, Esq.

From: Lawfinders Associates, Inc.

Re: *Bankruptcy Research*

Date: March 1, 200x

I. INTRODUCTION

Pursuant to your request, we have researched bankruptcy and Georgia law to determine the extent of a security interest in poultry and whether that interest extends to the proceeds, products, accounts receivable, and offspring of the chickens. We have also reviewed the application of the Packers and Stockyard Act to determine whether it will have a potential impact on the bankruptcy court's analysis. The scope of the creditors' security interests will be determined by the language in the financing statement and the security agreement. Furthermore, it is unlikely that the Packers and Stockyard Act will apply to either the secured creditors or the debtor-in-possession lenders.

II. BANKRUPTCY CONSIDERATIONS

Pre-petition security interests do not extend to the property acquired by a debtor's estate after the commencement of a bankruptcy proceeding unless an exception applies. Title 11 U.S.C. § 552(a). Section 552(b)(1) is an exception to the general rule enumerated in Section 552(a) and extends security interests to proceeds, product, offspring, or profits that are acquired after the bankruptcy petition has been filed. The court must look to state law to determine whether a security interest extends to proceeds, offspring, product, or profits. *See Financial Security Assurance, Inc. v. Tollman-Hundley Dalton, L.P.*, 74 F.3d 1120, 1123 (11th Cir. 1996). Although the court should not use non-bankruptcy law to determine the meaning of terms in Section 552, it should use state law to define the extent of security interests. *Id.* at 1124. Accordingly, if the bankruptcy court follows the law in the Eleventh Circuit, it will look to Georgia state law to determine the extent of the security interest under the financing statements executed by the debtor and the secured creditors.

A. Georgia Law Requires an Express or Implied Intent to Extend the Security Agreement to After-Acquired Property.

The creditors will likely not have an interest in any after-acquired property unless their financing statements and the security agreements adequately describe the after-acquired

interest in the property. Although there are no magic words in financing statements or security agreements that invoke an after-acquired security interest, a creditor must include a sufficient description so that a reasonable person looking at both the financing statement and the security agreement would recognize that the parties intended to secure after-acquired property. *Kubota Tractor Corp. v. Citizens & Southern Nat'l Bank*, 198 Ga.App. 830, 836, 403 S.E.2d 218 (Ga. App. 1991). Accordingly, the language in the financing statements and security agreements will determine whether any after-acquired poultry (or eggs), accounts receivable, or proceeds are secured by the notes with the secured creditors.

We were unable to locate any bankruptcy cases in Georgia directly addressing whether a security interest in poultry would extend to the offspring and the proceeds therefrom. However, the bankruptcy court may review potentially analogous cases to determine the proper approach. One Georgia bankruptcy court held that a Farmer's Home Administration (FmHA) security interest in all livestock, farm products, and supplies, owned at the time of the agreement or acquired after the agreement extended to the proceeds obtained from the post-petition sale of milk. *In the Matter of Hollie*, 42 B.R. 111, 117 (Bankr. M.D. Ga. 1984). Specifically, the court determined that milk was a farm product as defined in the Georgia statutes, and that because the FmHA had a perfected security interest in after-acquired farm products, it also had a perfected interest in the proceeds from those products. *Id.* Both born and unborn livestock are considered farm products under Georgia law. *See* O.C.G.A. § 11-9-102(35)(B). If the bankruptcy court adopts this analysis and if the security agreement extends to after-acquired poultry or farm products, then the eggs are likely subject to the perfected security interest as well.

It is important to analyze the language of Section 552 to determine the scope of the security interest in the debtor's property. Section 552(b)(1) expressly requires the creditors to have a pre-petition security interest in the proceeds, product, offspring, or profits of such property before the interest will extend to the post-petition proceeds, product, offspring, or profits. Title 11 U.S.C. § 552(b)(1). Additionally, even if the court determines that the creditors have perfected, enforceable security interests under 552(b)(1), the court can use its equitable power to order that the security interests are no longer valid. Depending on the language of the security agreements and financing statements, the debtor may be able to argue that either section 552(b)(1) does not apply, or that even if the section does apply, the court should balance the equities and eliminate the creditors' secured interests.

B. Provided that the Security Agreement Properly Describes the Collateral, the Proceeds from Disposition of the Collateral Will Likely Be Subject to the Security Interest under Georgia State Law.

Under Georgia law, a secured creditor's perfected interest in collateral extends to identifiable cash proceeds from the sale of that collateral. *See Dixie Production Credit Ass'n*

v. Kent, 167 Ga.App. 714, 307 S.E.2d 277 (Ga. App. 1983). In *Dixie Production*, the Dixie Production Credit Association (PCA) made a loan and took a security interest in Kent's swine livestock and its proceeds. *Id.* at 714. Georgia law protects a secured creditor where a filed financing statement covers original collateral and the proceeds from the disposition of the collateral are identifiable cash proceeds. *Id.* at 715. *See also* O.C.G.A. § 11-9-306(3)(b). In *Kent*, the sale of the hogs was not a cash sale, the buyers reduced a debt owed by Kent in exchange for the swine livestock. *Id.* Even though the sale was not for cash, the court determined that there were identifiable cash proceeds and that the full sales price of the livestock was subject to the creditor's perfected security interest in the livestock. *Kent*, 167 Ga.App. at 715. Provided that the creditors have secured interests in the poultry, it is likely that the creditors here will have perfected security interests in any identifiable cash proceeds from the sale of that poultry.

The creditors will also have perfected security interests in identifiable proceeds if the security interest are purchase money security interests. A perfected purchase money security interest in farm products or livestock takes priority over other security interests. O.C.G.A. § 11-9-324(d). Agricultural or farm products include livestock, poultry, eggs, and milk. O.C.G.A. § 1-3-3(4.1). This priority extends to identifiable proceeds, provided that *inter alia*, the purchase money security interest was perfected when the debtor received possession of the livestock. O.C.G.A. § 11-9-324(d)(1). If the creditors have perfected purchase money security interests in the poultry, they may be in a stronger position for bankruptcy analysis because the proceeds are not statutorily limited to cash proceeds, as they are in 11-9-306(3)(b).

C. Recent Decisions in Courts within the Fifth and Eleventh Circuits Will Likely Be of Limited Use in the Court's Analysis.

Bankruptcy courts that have reviewed the extent of security agreements in chicken and their offspring look to the security agreement and its scope under state law to determine whether a creditor has an interest in property acquired post-petition. There are few cases interpreting the current language in Title 11 U.S.C. Section 552(b)(1). Section 552(b) was revised as part of the Bankruptcy Reform Act of 1994. As a result, not many courts have examined the application of the Section 552(b)(1) as it now exists. There have been 30 cases since 1995 that mention Section 552(b)(1). None of those cases were in the Eleventh Circuit or in Georgia. Based on your instructions, we reviewed only cases in the Fifth and Eleventh Circuit courts. There are two bankruptcy cases in the Middle District of Florida, and one Louisiana district court case.

The Middle District of Florida's decision in *In re Lykes Bros S.S. Co., Inc.*, 215 B.R. 856 (Bankr. M.D. Fla. 1996) may prove helpful because it outlines the elements a creditor

must satisfy to save a claimed interest from the invalidating provisions enumerated in Section 552(a). In *Lykes*, a debtor-in-possession owned a fleet of ocean-going vessels and sought a determination by the court that the interests claimed by creditors in post-petition charter payments were not subject to the exception in Section 552(b)(1). *Id.* at 858-59. It was undisputed that the creditors had a pre-petition interest in the charter hire payments. *Id.* at 863. The court held that the creditor had to establish four elements before a pre-petition security interest would qualify for the exception in Section 552: (1) the terms of the security agreement expressly extend the security interest to after-acquired proceeds, product, offspring, or profits of the collateral; (2) the after-acquired property fits into the categories listed in Section 552(b)(1); (3) no statutory exceptions apply; and, (4) that the equities do not require the court to avoid applying the exception in 552(b)(1). *Id.* at 863-64. In *Lykes*, the court determined that post-petition charter hire payments were not proceeds as defined in Section 552(b). *Id.* at 864. Specifically, the court limited the definition of the term of proceeds to those instances where other property is substituted for the collateral. *Id.* The court held that a more broad definition of the term proceeds would subject all post-petition revenue generated by use of the collateral to the exception in Section 552(b). *Id.* This case may be helpful in convincing the court that it should apply a limited definition of proceeds and only include in the definition of proceeds money that was received for the sale of chickens.

In 1995, a bankruptcy court in the Middle District of Florida considered whether an increase in the cash value of a life insurance policy was subject to a pre-petition security interest in the policy. In *In re Englander*, 202 B.R. 326 (Bankr. M.D. Fla. 1995), Englander received a pre-petition loan from a bank. *Id.* at 327. As security for the loan, Englander assigned his interest in a life insurance policy to the bank. *Id.* Later, Englander filed bankruptcy. *Id.* He did not list the policy on his schedules, but he continued to pay insurance premiums post-petition. *Id.* The value of the policy increased while the bankruptcy proceeding progressed. *Id.* The bank claimed that it had a security interest in the increased cash value of the policy. *Id.* at 329-30. The court, relying on the Eleventh Circuit's decision in *Jones v. First Nat'l Bank of Atlanta*, 908 F.2d 859 (11th Cir. 1990), determined that payments made by the estate that increased the cash value of a life insurance policy were not "proceeds, product, offspring, or profits" for purposes of Section 552(b)(1) analysis. *Englander*, 202 B.R. at 330. The court held that although post-petition interest earned from a certificate of deposit would be subject to a pre-petition security interest, money deposited into a bank account post-petition would not be subjected to a pre-petition security interest. *Englander*, 202 B. R. at 330. While the analysis in *Englander* may be instructive, the application of the reasoning to a case involving proceeds from livestock will likely be limited.

In *Johnson v. Cottonport Bank*, 259 B.R. 125 (W.D. La. 2000), the court evaluated whether post-petition payments on a pre-petition obligation were subject to the invalidation

provision in Section 552(a). Johnson was entitled to a monthly payment from a local gambling casino. *Id.* at 127. Johnson granted a pre-petition security interest in the monthly payments as collateral for a loan with the Cottonport bank. *Id.* The court determined that typically a security interest remains enforceable after bankruptcy provided that the property is acquired before the debtor files his or her petition. *Id.* at 128. The court decided that the bank held an interest in Johnson's right to receive payments from the Tribe and that the payments were either proceeds from the right to receive payments or were themselves the original collateral. *Id.* at 129. This decision will likely be of little assistance because the subject matter and the analysis are only tangentially related to the application of Section 552(b)(1) to offspring of livestock.

In light of the absence of controlling law regarding poultry in bankruptcy proceedings in the Fifth and Eleventh Circuits, the bankruptcy court treatment of poultry in other contexts may be helpful. In *In re Barton*, 132 B.R. 23 (Bankr. W.D. Ark. 1991), the FmHA received an Assignment of Proceeds from the Sale of Products and argued that it had a security interest in payments to the debtors under a growing agreement. *Id.* at 25. The court rejected the FmHA's claim because the payments to the debtors were for the care and growth of the flock, not for the sale of chickens. *Id.* at 25. In *In re Dakota Lay'd Eggs*, 68 B.R. 975 (Bankr. D. N.D. 1987), the gap creditors requested that their claims be paid as administrative expenses to circumvent a bank's purchase-money security interests in chickens. *Id.* at 976. The court rejected the claim that the gap creditors were entitled to administrative fees for preserving the bank's collateral by providing food and care for the collateral. *Id.* at 979. Finally, in *In re Germany*, 73 B.R. 19 (Bankr. S.D. Miss. 1986), the court in a Chapter 13 case determined that FmHA could not have a security interest in proceeds from egg production sales because title to both the chickens and the eggs remained with an entity other than the debtor. *Id.* at 21. Although none of these cases are controlling and none address Section 552, the analysis contained within the cases may provide some instruction as to treatment.

III. POTENTIAL EFFECT OF THE PACKERS AND STOCKYARD ACT ON CURRENT AND FUTURE CREDITORS.

It is unlikely that the Packers and Stockyard Act (PSA) will discourage secured creditors from foreclosing on poultry collateral because it will be difficult for any secured creditor to meet the requirements established in the PSA. A trust is only created by the PSA on poultry obtained by a live poultry dealer through a cash sale or a growing arrangement. The secured creditors will probably not be defined as live poultry dealers because upon any foreclosure, they would likely fit the definition of a poultry grower, and in any event, the poultry would not be obtained through a cash sale or a growing arrangement.

A. The Secured Creditors are Probably Not Subject to the Packers and Stockyard Act.

The PSA will probably not be a vehicle to convince the secured creditors to refrain from foreclosing on the collateral. The PSA provides that any live poultry dealer holds any poultry (and any proceeds from the poultry or poultry products) obtained by cash sales or by growing arrangement in trust until the sellers or growers of the poultry have been paid. Title 7 U.S.C. § 197(b). A live poultry dealer is “any person engaged in the business of obtaining live poultry by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter by another.” Title 7 U.S.C. § 182(10). A poultry growing arrangement is “any growout contract, marketing agreement, or other arrangement under which a poultry grower raises and cares for live poultry for delivery in accord with another’s instructions.” Title 7 U.S.C. § 182(9). The secured creditors will probably not qualify as live chicken dealers and they will not obtain the live poultry through a cash sale or a growing arrangement.

The secured creditors, by taking possession of the poultry, will merely become poultry growers, not poultry dealers. A poultry grower is any person engaged in the business of raising and caring for live poultry for slaughter. Title 7 U.S.C. § 182(8). The PSA is not implicated unless all the requirements have been met. *See In re Chi-mar Foods, Inc.*, 207 B.R. 594, 595 (Bankr. N.D. Ill. 1997). The four requirements to establish a claim under the PSA are: (1) a live poultry dealer was involved; (2) live poultry was purchased in cash sales or by poultry growing arrangement; (3) the claim is limited to the live poultry activities of the live poultry dealer; and (4) written notice is filed with the Secretary of Agriculture within 30 days of the date for making payment. *Chi-mar*, 207 B.R. at 596. In *Chi-mar*, several creditors held security interests in accounts receivable for a debtor who bought and sold dead chickens. *Id.* at 595. Another creditor, Three “S” Farms, Inc. (“Farms”) claimed that it had a superior interest in the receivables because a trust was created when the debtor took the dead chickens and did not pay Farms from the proceeds of the chickens. *Id.* The court rejected the PSA claim because the claim did not involve a live poultry dealer. *Id.* at 596. Here, the secured creditors would not be dealers they would be growers. By foreclosing on the debtor-in-possession’s property, they secured creditors will take possession of the collateral and would meet the definition of poultry growers in Section 182(8) instead of poultry dealers, as defined in Section 182(10).

Even if the secured creditors were poultry dealers instead of poultry growers, the PSA would not be applicable to the facts here. The secured creditors are probably not in the business of obtaining live poultry “by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter by another,” as is required by the definition of “live poultry dealer” in Title 7 U.S.C. § 182(10). As discussed in *Chi-mar*, a claim under the PSA does not arise until all of the elements are met. *Chi-mar*, 207 B.R.

at 595. The secured creditors would be obtaining the poultry through foreclosure, not through purchase or growing arrangement.

B. It Is Unlikely That the PSA Would Prevent a Debtor-in-Possession Lender from Foreclosing on its Collateral.

For the reasons outlined in the discussion above, potential lenders should not be discouraged from lending to the debtor-in-possession. The PSA applies only to live poultry dealers who acquire poultry by purchase or growing agreement. Title 7 U.S.C. § 197(b). The debtor-in-possession lenders will likely not be acquiring any poultry, they will merely be acquiring a secured interest in the poultry. In the event of a foreclosure, the PSA would not apply to the financing transactions between the debtor-in-possession and its lenders. Before the PSA would govern the transaction between the debtor and the lender, the lender would have to obtain poultry through purchase or growing agreement. It is not likely that the PSA will have an impact on any potential secured transaction for the debtor-in-possession.