

In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:

WEXLER FASHIONS, INC.
d/b/a Town & Country

Debtor

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Chapter 11 Case

Number 91-41934

MEMORANDUM AND ORDER

Debtor filed its petition under Chapter 11 of the Bankruptcy Code on September 26, 1991. The debtor-in-possession filed its Motion for Determination of Lien and for Use of Cash Collateral on October 18, 1991. A hearing was held on the Motion on November 12, 1991, to determine the extent of a secured creditor's interest, if any, in Debtor's layaway goods when the security agreement pledges Debtor's inventory. After consideration of the briefs submitted by the parties, the applicable authorities, and the evidence adduced at the hearing, I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

Debtor's Chapter 11 petition was filed on September 26, 1991. Since that date the debtor-in-possession, Wexler Fashions, Inc., doing business as Town & Country, has continued in possession of its property and the operation of its retail clothing sales business in Savannah.

Ameribank, N.A., is a secured creditor of the Debtor with a perfected interest in Debtor's inventory. Debtor borrowed \$100,000.00 from Ameribank and executed a note and security agreement, both dated October 14, 1988. *See* Debtor's Exhibit "2". A U.C.C. financing statement was filed on November 9, 1988, covering Debtor's inventory. *See* Debtor's Exhibit "6". Debtor renewed the loan for \$325,448.11 on September 28, 1990. This renewal note incorporated the prior written security agreement and added additional collateral for the debt. As noted on the renewal note, Ameribank obtained a personal guaranty from Edward Wexler dated September 28, 1990, secured by an assignment of an Equitable life insurance policy and a third deed to secure debt dated September 28, 1990, as recorded. Ameribank also obtained a personal guaranty and third deed to secure debt from Linda Wexler. *See* Debtor Exhibit "1".

Ameribank's security agreement is a standard form security agreement which defines inventory as follows:

'Inventory' is defined to include all finished goods inventory of Borrower, whether now or hereafter acquired, wherever located, including, without limitation, (1) all goods of Borrower held for sale or lease or furnished or to

be furnished under contracts of service, (2) all goods held for display or demonstration, (3) goods on lease or consignment, (4) returned or repossessed goods, and (5) supplies used or consumed in Borrower's business, together with all documents of title, dock warrants, dock receipts, warehouse receipts, bills of lading and all other documents ordering the delivery of, or evidencing title to, all or any portion of the foregoing.

Borrower will not sell, lease, exchange or otherwise dispose of any of the inventory without the prior written consent of Holder, except in the ordinary course of business for cash or on open account or on terms of payment ordinarily extended to its customers. Upon the sale, exchange or other disposition of the Inventory, the security interest and lien created and provided for herein, without break in continuity and without further formality or acts, shall continue in and attach to the proceeds thereof, including, without limitation, accounts, contract rights, shipping documents, documents of title, bills of lading, warehouse receipts, dock warrants, dock receipts, and cash or noncash proceeds and, in the event of any unauthorized sale, shall continue in the Inventory itself.

See Debtor's Exhibit "2". This standard form also defines accounts receivable, and equipment, although no security interest was retained in either. Only the box for a pledge of inventory was checked on the security agreement form.

Ameribank contends that its security interest in inventory includes a security interest in and rights to Debtor's layaway items. According to Schedule "D", Creditors Holding Secured Claims, Ameribank has a secured claim for \$308,121.12 and an unsecured claim for \$158,121.12. Ameribank's collateral is listed in Schedule "D" as clothing merchandise for retail sale with a market value of \$150,000.00. Debtor lists two other

secured creditors on its Schedule "D". CNM, Inc., is listed with a \$39,000.00 claim in consigned clothing merchandise for retail sale. Also, LMK is listed as secured in the amount of \$7,492.93 with collateral listed as consigned clothing merchandise for retail sale.

At the hearing Edward Wexler, owner and operator of the debtor-in-possession, testified that the remaining inventory was worth approximately \$140,000.00 at retail and that the amounts pledged to Ameribank did not include layaways. Ameribank stipulated that the amount owed on the debt was \$313,463.61 and that the collateral pledged was not sufficient to cover the debt. Wexler testified that the balance due for layaways was approximately \$85,000.00. Mr. Wexler testified that his business sold clothing merchandise to its customers for cash, by charge, or on layaway and that a layaway purchase was treated the same as a charge account purchase with commissions paid on the sale. He said the layaway items were taken out of inventory and held separately for the customer until paid in full. Mr. Wexler testified that layaway purchases were to be paid in sixty days and that if the items were not paid for in the sixty day period, the items were returned to stock. Mr. Wexler also explained that the sixty day limit could be waived by agreement and extended for up to two years on large ticket items such as furs or jewelry. Debtor's Exhibit "5", the layaway slip, was admitted into evidence.

Debtor introduced into evidence its May 31, 1990, balance sheet. *See* Debtor's Exhibit "4". The assets listed on the balance sheet include the following separate accounts: (1) Accounts Receivable - Other; (2) Accounts Receivable Shoppers Charge

Accounts; (3) Accounts Receivable - Trade; (4) Accounts Receivable Credit Memos; (5) Accounts Receivable Layaway; (6) Inventory - Clothes; (7) Inventory - Furs. Debtor's balance sheet reflects that layaway sales are treated as a separate accounts receivable account. *See also* Debtor's Exhibit "3", a September 6, 1988, balance sheet which includes similar accounts.

Certain accounts are assigned to Shoppers Charge as indicated on the balance sheet. Mr. Wexler asserted at the hearing that the Bank knew of this assignment and claimed no interest in any of the accounts receivable. This testimony was not disputed.

The layaway agreement provides:

TERMS

Layaways are final sales. No exchanges. No refunds. Layaways must be out by sixty days. Payment is required every two weeks.

If payment is missed layaway may be returned to stock with deposit and payments forfeited.

See Debtor's Exhibit "5".

Mr. Al Pace, the former Ameribank president who negotiated the original loan with the Debtor, testified at the hearing. Mr. Pace is now employed as a business consultant and has performed consulting work for the Debtor. Mr. Pace testified that Debtor

was not required to remit cash proceeds to the Bank after inventory was sold. He testified that the Bank expected the loan to be repaid in monthly installments from inventory sales and cash flow. On the "Loan Summary" or Loan Report, Ameribank's Exhibit "1", the source of repayment is listed as "conversion of assets . . . loan to be repaid from cash flow." Mr. Pace also testified that the Bank's lien was to cover only inventory on the floor and did not include proceeds, layaway merchandise, or accounts receivable.

Similarly, according to Debtor, Ameribank's security interest covers only the floor inventory of Debtor not consigned by third parties and does not include layaway merchandise or receivables therefrom.

Ameribank contends that layaway items remain inventory subject to its security interest, or alternatively that layaways are included within the definition of proceeds of inventory and are therefore included in its collateral.

As the parties announced at the hearing a settlement regarding Debtor's use of cash collateral, that part of Debtor's Motion regarding cash collateral is not considered in this order.

CONCLUSIONS OF LAW

Ameribank has a security interest in Debtor's inventory pursuant to a security agreement. *See* Debtor's Exhibit "2". Ameribank also filed a financing statement covering the collateral and giving Ameribank a properly perfected security interest in Debtor's inventory under O.C.G.A. Section 11-9-303. *See* Debtor's Exhibit "6".

I. Layaway as Inventory or Accounts Receivable.

The Uniform Commercial Code defines inventory as follows:

Goods are:

- (4) 'Inventory' if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process, or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

O.C.G.A. §11-9-109(4). Ameribank first argues that a layaway purchase is not a final sale and that goods on layaway are still held for sale to a specific customer and thus remain inventory, subjecting the layaway merchandise to the Bank's security interest.

As noted above, inventory is defined as goods held for sale or lease. Ameribank argues that the goods were never "sold." Ameribank cites Holland v. Brown, 15 Utah 2d 422, 394 P2d 77 (1964), in which the court concluded that a layaway transaction was an option to purchase and not a final sale. In Holland, the seller had scratched through

certain portions of its sales contract and had handwritten the term layaway. The court determined that the handwritten provisions prevailed over the written contract provisions and created an ambiguity and jury question as to whether or not the parties intended to enter a contract for a binding and final sale. However, Holland is distinguishable because in this case Debtor has a separate layaway agreement which specifically states that the transaction is a final sale. *See* Debtor's Exhibit "5". Since Debtor accounts for the layaway transaction as a sale when the layaway agreement is signed, and not upon final payment, pays sales tax and commissions when the item is placed on layaway, and treats layaways as a separate asset on its financial statements (*See* Debtor's Exhibit "3" and "4") I conclude that the layaway sale is "final." Any subsequent agreement by Debtor to reverse the sale is at Debtor's sole option and does not alter the terms of sale as being final.

In the event the layaway sale is reversed the inventory lender reacquires a perfected security interest in the reacquired inventory. O.C.G.A. Section 11-9-306(5) provides:

If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

- (a) If the goods were collateral at the time of sale for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally

perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

- (c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a) of this subsection.

Given the evidence at the hearing and the applicable authorities, I conclude that layaway purchases in this case constitute final sales. Thus, amounts due on layaway should be treated as an account receivable which were not specifically pledged to Ameribank.

II. Layaway as Proceeds of Inventory.

However, as an alternative Ameribank claims that its security interest continues in the layaway as proceeds of the sale of inventory. Under O.C.G.A. Section 11-9-306(1) "proceeds" includes:

Whatever is received upon the sale, exchange, collection, or other disposition of collateral or proceeds Money, checks, deposit accounts, and the like are 'cash proceeds.' All other proceeds are 'non-cash' proceeds.

O.C.G.A. §11-9-306(1). The security agreement specifically states that Ameribank's interest continues in proceeds including "accounts." The U.C.C. provides that a security interest

continues in proceeds without the creditor having to specifically mention proceeds in his security agreement or financing statement. *See* §11-9-203(3); §11-9-306(2); §11-9-312(6). The Official Comments to the Uniform Commercial Code specifically state that it is unnecessary to claim proceeds expressly in a financing statement and provides in effect that a filing as to original collateral is also a filing as to proceeds . . . U.C.C. §9-312, Comment 4. Ameribank's security agreement included inventory and proceeds. The financing statement referred only to inventory; however, under the U.C.C., specific reference to proceeds in the financing statement is unnecessary.

Additionally, the security interest in proceeds may be continuously perfected under O.C.G.A. §11-9-306(3) which provides:

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless:

(a) A filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may (taking into account Code Section 11-9-401(2) and (3)) be perfected by filing in the office or offices where the financial statement has been filed . . .

As a financing statement for a security interest in accounts may be filed in the same office in Chatham County where a financing statement for a security interest in inventory is filed, Ameribank has a properly perfected security interest in inventory as well as accounts as

proceeds of the inventory. According to the Official Comments which follow U.C.C. Section 9-312:

If a financing statement is filed covering inventory, then (subject to the exception involving multistate problems) this filing is also a filing as to the resulting accounts and constitutes the date of filing as to the accounts.

It follows that even if Ameribank's documents had not specifically stated that its security interest continued in accounts, the Uniform Commercial Code provides for the security interest to continue in such non-cash proceeds under Section 306(3). Since the amount due from layaway purchases constitute accounts receivable and represent proceeds from the sale of inventory, Ameribank has an automatic perfected security interest in those accounts and if the sale is reversed in the goods.

Although parol evidence as to surrounding circumstances is admissible to explain ambiguities and to aid in construction of contracts, parol evidence which contradicts or varies terms of a written instrument is not admissible. Kellos v. Parker-Sharpe, Inc., 245 Ga. 130, 263 S.E.2d 138 (1980). As the security agreement, interpreted in light of the applicable provisions of the U.C.C., clearly and unambiguously gives Ameribank a security interest in proceeds, which would include accounts such as layaway, the testimony of Mr. Pace, the Bank president who testified as to the intent of the Bank at the time the security

agreement was signed, is not admissible to vary the terms of the security agreement.¹ The parties to the security agreement are deemed to be aware of the applicable provisions of the U.C.C. giving a secured creditor with an interest in inventory an interest in accounts as proceeds of inventory sales, and are bound by it.

CONCLUSION

The parties stipulated that Ameribank's claim is \$313,463.61 and is currently undersecured, even if the full value of layaways is considered. Ameribank's claim is therefore deemed secured to the extent of Debtor's inventory including layaway items, and the balances due on such items.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ___ day of March, 1992.

¹ This testimony, however, is admissible to interpret the latent "ambiguity" as to whether the term inventory includes layaway items and my ruling on that issue is consistent with his testimony as to the parties' understanding of that term.