

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA  
Statesboro Division

IN RE:	)	Chapter 7 Case
	)	Number <u>83-60116</u>
DILLARD FORD, INC.	)	
	)	
Debtor	)	
	)	
WILLIAM E. WOODRUM, AS TRUSTEE	)	FILED
	)	at 12 O'clock & 18 min P.M.
Plaintiff	)	Date: 12-15-89
	)	
vs.	)	
	)	
FORD MOTOR CREDIT COMPANY	)	
	)	
Defendant	)	

**ORDER AND JUDGMENT**

William E. Woodrum, as trustee for debtor Dillard Ford, Inc., brought this adversary proceeding to recover property which allegedly was part of the debtor's bankruptcy estate. The trustee seeks an order to require defendant, Ford Motor Credit Company, to surrender amounts retained by the defendant in an account known as Dealer Proceeds Withheld Account (hereinafter referred to as the DPW account). In addition, the trustee seeks to recover from the defendant proceeds allegedly due debtor as a result of the defendant accepting the assignment of two retail installment contracts. After

a careful review of the proposed findings of fact and conclusions of law submitted by the parties, and the evidence adduced at trial, the court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The debtor, Dillard Ford, Inc., was a new and used car dealer in Metter, Georgia. The debtor used Ford Motor Credit Company to finance retail sales of automobiles and to finance its inventory of new automobiles under a floorplan financing agreement.

2. As part of the floorplan financing arrangement, the debtor was required to execute an agreement entitled "Automotive Wholesale Plan - - Application for Wholesale Financing and Security Agreement." (Plaintiff's Exhibit No. 1) This agreement created a purchase money security interest in favor of Ford Motor Credit Company in inventory "now owned or hereinafter acquired" by the debtor, as well as in the proceeds of the inventory.

3. The debtor also executed a financing statement dated January 15, 1980 which covered:

- (1) New and used motor vehicles, tractors, trailers, semi-trailers, mobile homes, farming implements and other farming or industrial appliances and equipment, and other inventory and equipment with manufacturer certificates and certificates of title or ownership relating thereto;
- (2) accessories and replacement parts of or for any of the above;
- (3) accounts, contract rights, chattel paper,

and general intangibles; and  
(4) proceeds derived from any of the above collateral.

4. The debtor also entered into Retail Installment Contracts with the purchasers of the automobiles in the debtor's inventory. As part of the retail financing transaction, the debtor would issue a sight draft drawn on the defendant's account to fund the retail purchaser's loan and would deposit the sight draft in debtor's bank account. The debtor would then issue a check to pay off any lien on the motor vehicle.

5. The Retail Installment Contracts were then assigned to the defendant and the sight draft paid the debtor the face value of the contract less the discount rate. A portion of these proceeds due the debtor as determined from the discount rate were withheld by the defendant on each transaction and retained as part of the DPW Account. At the time of the assignment of the contract, the debtor was required to execute a repurchase receipt, which provided for repurchasing the contracts if the retail customer defaulted on the terms of the loan. (Plaintiff's Exhibit No. 5).

6. The DPW Account is only a written record of sums due the debtor. No separate account existed in which these funds were set aside for the debtor, but the money was co-mingled with other funds of the defendant.

7. The terms of the DPW Account made provisions for periodic disbursements to the debtor if the account reached a specified sum, and also allowed the defendant to discontinue these disbursements if the debtor regularly failed to submit retail installment contracts to the defendant.

8. Both the Automotive Wholesale Plan -- Application for Wholesale Financing and Security Agreement, which governed the floorplan financing arrangement, and the Repurchase Receipt, which governed the retail financing relationship, incorporated by reference a manual entitled "Automotive Finance Plans for Ford Motor Company Dealers" (hereinafter referred to as the Dealer's Manual). (Plaintiff's Exhibit No. 4) The Dealer's Manual provided that, "Ford Credit may withhold a portion of the Dealer Proceeds as security for all of the Dealer's obligations to Ford Credit and its subsidiaries." (Plaintiff's Exhibit No. 4, p.19)

9. Paragraph 7 of the Automotive Wholesale Plan -- Application for Wholesale Financing and Security Agreement (Plaintiff's Exhibit No. 1) provided, "Ford Credit, at all times, shall have a right to offset and apply any and all credits, monies, or properties of Dealer in Ford Credit's possession or control against any obligation of Dealer to Ford Credit."

10. This contractual relationship between the debtor and the defendant was executory. When the debtor filed its petition for protection under the bankruptcy code on September 9, 1983 neither

party had fully performed under the terms of the contract. The trustee has not assumed the contract.

11. On September 30, 1983, the DPW Account had a balance of Thirty-Six Thousand Two Hundred Eighty- Three and 52/100 (\$36,283.52) Dollars (Plaintiff's Exhibit No. 6). The defendant has represented that at the present time the account has a balance of Twenty-Four Thousand One Hundred Thirty-Nine and 39/100 (\$24,139.39) Dollars because of rebates made to customers who have prepaid their contracts or because of repossessions.

12. On August 29, 1983, debtor entered into la Retail Installment Contract with Radio Metter (hereinafter referred to as the Radio Metter Contract) in which Radio Metter financed Thirteen Thousand One Hundred Fifty-Five and No/100 (\$13,155.00) Dollars. The debtor issued a sight draft on this contract and deposited the draft into its account. The sight draft was not honored by the defendant's bank on the direction of the defendant, and the debtor had no proceeds with which to pay the lienholder on the vehicle, Savannah Bank and Trust, now known as First Union Bank. The vehicle that was the subject of the Radio Metter Contract was not a part of the floorplan financing agreement with the defendant.

13. On August 30, 1983, debtor entered into a Retail Installment Contract with J. Dorsey Smith (hereinafter the Smith Contract) in which the amount financed was Sixteen Thousand One

Hundred Forty-Four and 73/100 (\$16,144.73) Dollars. The contract was assigned to defendant, but the testimony is conflicting as to whether a sight draft was issued by the debtor and not honored, or whether the debtor did not issue a sight draft on this contract. However, it is not in dispute that the debtor did not directly receive any funds from defendant for this assignment.

14. On August 31, 1983, defendant received two checks made payable to defendant by the debtor and returned by plaintiff's bank unpaid because of insufficient funds. The two checks were to pay off the wholesale floorplan financing on two cars sold by the debtor to a retail customer and covered by the floorplan financing agreements. The two checks totaled Seventeen Thousand Three Hundred Seventy-Four and No/100 (\$17,374.19) Dollars.

15. Upon receipt of the checks, defendant's agent, Lum Purvis, took possession of the checks and went to the debtor's place of doing business. Mr. Purvis conducted a wholesale inventory audit of the debtor's inventory and records. The audit revealed another check drawn against insufficient funds and made payable to the defendant.

16. Based on the audit, Mr. Purvis, as agent for the defendant, suspended the debtor's sight draft privileges. In addition, Mr. Purvis took possession of two retail installment contracts, one of which was the Smith Contract, which contracts had

been assigned by the debtor to defendant and advised the debtor's bookkeeper not to issue sight drafts on the two contracts.

17. In addition to the two contracts which Mr. Purvis took from the debtor's dealership, there were two additional contracts, one of which was the Radio Metter contract, which the debtor had executed and forwarded to the defendant's Savannah branch office. These two contracts were in the defendant's office when Mr. Purvis returned from the debtor's dealership after conducting the audit.

18. The four contracts which defendant had in its possession after suspending the debtor's wholesale line of credit and sight draft privileges were funded with checks drawn on defendant's bank. The proceeds from these four contracts were used to reduce the debtor's wholesale financing debt owed to defendant.

#### CONCLUSIONS OF LAW

The DPW Account, or Dealer Reserve Account as it is often referred to, has been held to be the property of a debtor's bankruptcy estate subject to any valid security interest a creditor may have in the account. Walker v. Commercial Credit Corp., No. CV182-212 (S.D. Ga. filed March 16, 1983). The Dealer Reserve Accounts in the Commercial Credit Corp. opinion were substantially similar to the DPW account now at issue before this court. Here, as in Commercial Credit Corp., the price of the retail contract was

determined at the time of purchase and was credited to the debtor less the discount charge and other payments made on behalf of the debtor. Like this defendant, Commercial Credit Corp. maintained the DPW account to cover rebates on unearned finance charges to retail customers who paid off their loans early or to cover deficiencies on repossessed collateral not repurchased by the dealer. The DPW account represents an additional mark-up in the interest rate of the retail installment contract above the defendant's discounted rate and were held as security for the obligations the debtor may owe to defendant. The account provided assurance that the debtor's obligations would be paid if and when they arose. "Consequently, the more logical way to view the accounts is as a means of retaining the established purchase price of the sales contracts, deferring payments until certain conditions exist and subject to contingent obligations. Thus, the accounts are property of the [debtor]." Commercial Credit Corp., supra at 8. The accounts therefore, became a part of the debtor's bankruptcy estate subject to any valid security interest the defendant may have in the accounts.

To perfect a security interest in the accounts, the defendant must have filed a valid financing statement. Commercial Credit Corp., supra at 9; O.C.G.A. §11-9-305. Mere possession of the account records is not sufficient to perfect a valid lien on the accounts. Commercial Credit Corp., supra. The defendant now before the court did file of record a UCC-1 financing statement

which it contends covered the DPW account. The financing statement filed by the defendant was almost identical to the financing statement filed by the defendant in Citicorp Homeowners, Inc. v. Walker, No. CV185-104 (S.D. Ga. filed Nov. 7, 1985).

The facts of Citicorp are substantially similar to the ones now before the court. The trustee sought to recover proceeds from a dealer reserve account held by defendant, Citicorp Homeowners. Citicorp Homeowners had filed a financing statement, but the court held that the reference to "accounts" and "general intangibles" in the financing statement was so overbroad that it did not "reasonably identify anything related to the dealer reserve accounts." Id. at 5. The court held that the statement failed to adequately describe the collateral sufficiently to warn other creditors of the secured claims against the dealer reserve accounts. Id. The financing statement filed by the defendant, Ford Motor Credit, in the case now before the court made no substantial changes in its language to encompass the DPW account, and the court can find no basis to distinguish this case from the district court's analysis in the Citicorp Homeowners decision.<sup>1</sup> Pursuant to Citicorp Homeowners, supra, this court finds that the defendant held no

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<sup>1</sup>The defendant in its supplemental brief sets forth no basis to distinguish the current case from the Citicorp decision, but basically contends that the district court erred. This decision will provide the defendant the opportunity to convince the district court of its error and the error of this court.

perfected security interest in the DPW accounts.

In addition, the district court has rejected the contention that a defendant has any right to setoff with respect to a DPW account. See Citicorp Homeowners, supra. In Citicorp Homeowners, the district court concluded that the dealer reserve accounts were "not debts of the bankruptcy estate", but were unencumbered assets of the estate to which no right of setoff existed under 11 U.S.C. §553. The court concluded that the dealer reserve account was not an "account" or a "general intangible" as set forth in the financing statement filed by the defendant, and did not represent money owed the estate by the defendant. As this court can find no basis to distinguish the dealer reserve accounts in

Citicorp Homeowners from the present DPW account, this court is compelled to follow the decision rendered by the district court. Based on the previously referenced decisions of the district court, the DPW account is a tangible asset of the estate which must be specifically described in a financing statement and to which no right of setoff exists under §553 of the Bankruptcy Code. See Citicorp Homeowners, supra; Walker v. Financeamerica Private Brands (In re: Ponderosa Mobile Homes), Ch. 7 No. 181-00193, Adv. No. 181-0066 (Bankr. S.D. Ga. filed Nov. 12, 1984). But see, Stair v. Hamilton Bank of Morristown, 42 B.R. 413 (Bankr. E.D. Tenn. 1984); Lubman v. Sovran Bank, 98 B.R. 243 (Bankr. E.D. Va. 1989); Coppa v.

Security Bank of Nevada, 60 B.R. 760 (Bankr. Nev. 1986); John Deere Industrial Equipment Co. v. Southern Equipment Sales Co., 24 B.R. 788 (Bankr. N.J. 1982). The trustee is entitled to recover the DPW account as property of the debtor's bankruptcy estate.

The amount of the DPW account is also a matter of controversy. On September 30, 1983, the amount of the DPW account was Thirty-Six Thousand Two Hundred Eighty-Three and 52/100 (\$36,283.52) Dollars. At trial, defendant's agent, Mr. Purvis, testified that the amount of the DPW account was only Twenty-Four Thousand One Hundred Thirty-Nine and 39/100 (\$24,139.39) Dollars. This lower amount, according to Purvis, reflected reductions in the account for customer rebates or repossessions as allowed by the contracts entered into by the debtor and defendant. However, by prior order of this court, the defendant was ordered "to hold intact all funds presently held by it in a reserve account established for the purpose of satisfaction of defaulted retail installment contracts." In re: Dillard Ford, Ch. 7 No. 683-00116 (Bankr. S.D. Ga. filed Nov. 17, 1983). The order provided no exceptions to allow the defendant to make deductions from the account for any purpose and any attempted deductions made in the account were made in violation of the prior order. Under the authority of the prior decisions of the district court, the trustee is entitled to recover the amount of Thirty-Six Thousand Two Hundred Eighty-Three and 52/100 (\$36,283.52) Dollars from the defendant.

The two contracts, the Radio Metter and Smith contracts, for which trustee seeks to recover the proceeds which the defendant credited against the balance owing on the debtor's wholesale financing debt require a different analysis. The contracts were assigned to the defendant and the defendant credited the amount usually given to the debtor under the retail financing arrangement against the amount owed on the debtor's wholesale financing obligations. The trustee seeks to recover these funds as a preferential transfer under 11 U.S.C. §547. However, these funds in possession of the defendant would be subject to the right of setoff, preserved by 11 U.S.C. §553.

A creditor's right to setoff is established by showing:

- (1) a prepetition debt owed by the creditor to the debtor, and
- (2) a prepetition claim owed by the debtor to the creditor, and
- (3) mutuality of the debt and the claim.

Coppa v. Security Bank of Nevada, 60 B R. 760 (Bankr Nev. 1986). A "prepetition debt" simply means a liability on a claim that existed before the debtor filed for protection under Title 11. Coppa, supra; 11 U.S.C. §101(11). "A claim is a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . ." Coppa, supra [quoting 11 U.S.C. §101(4) (A)]. Although the bankruptcy code does not define mutuality of debts, the basic test is that an obligation

must be owed by the debtor to the creditor, and an obligation must be owed by the creditor to the debtor. 4 Collier on Bankruptcy ¶553.04 (L. King 15th ed. 1989); Coppa, supra. The claims against the debtor by the defendant are for obligations incurred by the debtor under the Wholesale Financing Agreement which covered the debtors pre-petition inventory. The claims of the debtor against the defendant are for pre-petition retail installment contracts purchased by the defendant from the debtor before the debtor filed its petition in bankruptcy. There were mutual obligations owing between the parties that would be subject to setoff under 11 U.S.C. §553.

Although §553 does give the defendant the right to off set the amounts due the debtor on the Smith and Radio Metter Contracts, the provision also provides the basis to allow the trustee to recover the amount which the defendant set off in the ninety (90) days preceding the debtor's petition in bankruptcy if the defendant

improved its position by off setting the mutual obligations See 11 U.S.C. §553(b).<sup>2</sup> The test for recovery under 553(b) is similar to

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<sup>2</sup>11 U.S.C. §553(b) provides in pertinent part:

(b) (1) . . . if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any

the test imposed by 11 U.S.C. §547 when the trustee seeks to recover a preference, but the trustee is not required to establish that the debtor was insolvent to effect recovery of the proceeds. 11 U.S.C. §553(c); 2 Collier Bankruptcy Manual ¶553.07 (L.King 3rd ed. 1989). The trustee need only establish 1) that within the ninety (90) days prior to the petition in bankruptcy the defendant set off a mutual debt owed the debtor and 2) that the set off improved the creditor's position. Id. at ¶553.06. The overall effect of this provision is to discourage creditors from exercising their right to set off before a petition is filed. 2 Norton

Bankruptcy Law and Practice §33.01 (W. Norton 1981). "The result is to encourage business workouts, by discouraging precipitous action." H.R. Rep. No. 93-595, 95th Cong., 1st Sess. 186 (1977).

The defendant now before the court took precipitous action

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insufficiency on the date of such setoff is less than the insufficiency on the later of -

- (A) 90 days before the date of the filing of the petition; and
- (B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

§553(b) was designed to discourage. The setoff occurred~sometime after August 31, 1983. The debtor filed its petition in bankruptcy on September 9, 1983. The Smith and Radio Metter contracts which were assigned to the defendant were not executed by the retail customers until sometime in August, 1983. The obligation owed the debtor, arose within ninety days prior to the petition, and the right to setoff was exercised within that time period.

The setoff also improved the creditor's position. Based on an analysis of the amount of unsecured claims filed in the case and the amount of funds available for distribution by the trustee, the defendant, through the setoff, would receive a substantially higher dividend than the other unsecured creditors. The total unsecured claims filed against the debtor in the underlying Chapter 7 case total Four Hundred Twenty-Eight Thousand Five Hundred Fourteen and 18/100 (\$428,514.18) Dollars. The trustees interim report reveals only Twenty-Six Thousand Ninety-Five and 37/100

(\$26,095.37) Dollars available for distribution. If the funds recovered from the defendant for the DPW account are included, the total funds available for distribution would be Sixty-Two Thousand Three Hundred Seventy-Eight and 89/100 (\$62,378.89) Dollars, which would allow the creditors a Fourteen (14%) percent dividend. The

defendant, if allowed to retain the Twenty-Nine Thousand Two Hundred Ninety-Nine and 73/100 (\$29,299.73) Dollars it setoff against the

defendants wholesale debt, the defendant would realize a forty-seven (47%) percent dividend.<sup>3</sup> Such an improvement in position is not allowed under §553(b), and the trustee is entitled to recover the proceeds due the debtor on the Radio Metter and Smith contracts.

**ORDER**

It is therefore ORDERED that plaintiff, William E. Woodrum, Jr., as trustee for debtor, Dillard Ford, Inc., recover from defendant the sum of Thirty-Six Thousand Two Hundred Eighty-Three and 52/100 (\$36,283.52) Dollars as the proceeds of the DPW account and Twenty-Nine Thousand Two Hundred Ninety-Nine and 73/100 (\$29,299.73) Dollars as proceeds from the Radio Metter and Smith contracts plus interest at such rate as established by law until the judgment is satisfied.

JOHN S. DALIS  
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia  
this 15th day of December, 1989.

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<sup>3</sup>The defendant maintains that-it has a claim against the debtor for a deficiency of Thirty-Two Thousand and Ninety One and No/100 (\$32,091.00) Dollars after applying the proceeds better and Smith Contracts to the debtor's obligations was used to determine the dividend the defendant would receive since the defendant has not filed a proof of claim in the underlying Chapter 7 case.