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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

IN RE: DAVE KYLE JAMES and CHARLSIE ANN JAMES, Debtors.	§ § § § § §	 Case No. 08-43357 (Chapter 7)
HERITAGE PRODUCTION CREDIT, PCA, Plaintiff, v. DAVE KYLE JAMES, CHARLSIE ANN JAMES, and MARTINEK GRAIN & BINS, INC. d/b/a MCKINNEY GRAIN, Defendants.	§ § § § § § § § § § § § § §	 Adv. Proc. No. 09-4030

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This proceeding is before the Court following a trial of the Plaintiff's adversary complaint. In the complaint, the Plaintiff seeks a judgment against all of the defendants for conversion and money had and received, and the Plaintiff seeks a determination that the judgment against Dave and Charlsie James is nondischargeable pursuant to 11 U.S.C. § 523(a)(6). All parties consent to the entry of a final order by this Court. The Court exercises its core jurisdiction over this matter, *see* 28 U.S.C. § 157(b)(2)(I) and (K), and makes the following findings of fact and conclusions of law, *see* FED. R. BANKR. P. 7052.

I. Findings of Fact

1. At trial, the parties did not dispute the relevant facts. Their dispute distills to a disagreement as to whose secured interest in a 2008 crop of soybeans and corn has

priority – the interest of the Plaintiff or Martinek Grain & Bins, Inc. d/b/a McKinney Grain ("McKinney Grain").

2. The Plaintiff is the owner and holder of a promissory note dated September 17, 2007, in the original principle amount of $731,291.60. Dave K. James executed the note as president of Hanging 4J Farms, Inc., a Texas corporation, and Dave K. James and Charlsie A. James (collectively, the "Debtors") executed the note in their individual capacities. The note renewed and extended the unpaid balance owed on one or more prior loans from the Plaintiff to the Debtors and Hanging 4J Farms.

3. In addition, the Debtors and Hanging 4J Farms signed a security agreement for the benefit of the Plaintiff. The security agreement granted the Plaintiff an interest in "[a]ll debtors' right, title and interest in and to all Crops planted, growing, to be planted, grown or harvested, as well as the proceeds from the sale thereof, wherever located …."

4. The Plaintiff filed a UCC-1 Financing Statement with the Texas Secretary of State. The Plaintiff filed the UCC-1 in the proper names of Hanging 4J Farms and each of the Debtors. The UCC-1 described the Plaintiff's interest in crops planted or to be planted by the Debtors and Hanging 4J Farms.

5. In 2008, Hanging 4J Farms and the Debtors planted corn and soybean crops on several tracts of land. The Plaintiff did not advance any loan proceeds to the Debtors or Hanging 4J Farms to purchase seed, fertilizer or miscellaneous chemicals for the planting and harvesting of the 2008 crops.

6. McKinney Grain sold seed to Hanging 4J Farms, on credit, for the 2008 crops. McKinney Grain is the owner and holder of an "Open Account Promissory Note"

dated May 2, 2008 and signed by Dave James and Hanging 4J Farms. On or about July 11, 2008, McKinney Grain filed a notice of an agricultural lien with the Texas Secretary of State under Texas Agriculture Code § 128.010.[1]

7. In May 2008, the Plaintiff sent McKinney Grain a certified letter notifying McKinney Grain that the Plaintiff had a perfected interest in all the crops grown or to be grown by Hanging 4J Farms and the Debtors. Over the next several months, counsel for the Plaintiff and McKinney Grain exchanged letters in which they set out their respective legal positions regarding the priority of their interests in the 2008 crops.

8. In August, September and October 2008, McKinney Grain harvested Hanging 4J Farms' soybean and corn crops. McKinney Grain took possession of several thousand bushels of soybeans and corn with a total fair market value of $69,430.48. McKinney Grain retained the soybeans and corn in satisfaction of a part of the debts owed to it by Hanging 4J Farms and the Debtors.

9. Prior to the Debtors' bankruptcy, Acme Property & Casualty Insurance Company issued two checks in the total amount of $31,430 jointly payable to Hanging 4J Farms and McKinney Grain. The checks were for insured damage to the 2008 soybean crop. Dave James endorsed the checks and delivered them to McKinney Grain. McKinney Grain applied the proceeds from the checks to the unpaid balance of the debt owed to it by the Debtors and Hanging 4J Farms.

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[1] This provision states that "[a] lien created under this chapter is perfected on the filing of a notice of claim of lien with the secretary of state as provided by this chapter." A lien created under Chapter 126 of the Texas Agriculture Code "has the same priority as a security interest perfected by the filing of a financing statement on the date the notice of claim of lien was filed." TEX. AGRIC. CODE 126.026(a).

10. The actions of Dave James and McKinney Grain were based upon their good faith understanding of McKinney Grain's interest in Hanging 4J Farms' corn and soybean crops.

11. On December 11, 2008, the Debtors filed a voluntary petition for relief under Chapter 7 of the Code. On the same date, Hanging 4J Farms filed a voluntary petition for relief under Chapter 7 of the Code.

12. Any finding of fact that is construed to be a conclusion of law is hereby adopted as such.

II. Conclusions of Law

A. Priority Under the UCC

1. Prior to 1999, § 9-312(2) of the Uniform Commercial Code ("UCC") set out special priority rules as to conflicting security interests in crops. This provision, which was adopted in Texas as part of its Business and Commerce Code, stated as follows:

> A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops became growing crops by planning or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops became growing crops by planting or otherwise, even though the person giving the new value had knowledge of the security interest.

See TEX. BUS. COM. CODE § 9.312(b) (Vernon's 1999).

2. Article 9 was revised in 1999. The Revised Article 9 of the UCC deleted § 9-312(2). *See* 99 Hawkland UCC Series § 9-322:1 at fn. 3 (Rev. Nov. 1999) (discussing the revisions to UCC § 9-312). Instead, Appendix II contained a model

provision for a production money security interest, which is optional for any state that chooses to adopt it.

3. Texas adopted the Revised Article 9 effective July 1, 2001. Texas has not adopted the model provision for a production money security interest.

4. Section 9-322 of the Revised UCC sets out the general rules governing priorities among conflicting security interests and agricultural liens. *See* TEX. BUS. COMM. CODE § 9.322(a). "Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection." TEX. BUS. COMM. CODE § 9.322(a)(1).

5. McKinney Grain did not establish any provision of Texas law that would give its perfected interest in the soybean and corn crops priority over the previously perfected interest of the Plaintiff. *See* TEX. BUS. COMM. CODE § 9.322(g) ("A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides."). In its post-trial brief, McKinney Grain argued for the first time that its interest has priority under the Federal Crop Insurance Act, 7 U.S.C. § 1501 *et seq.* McKinney Grain did not include this issue in the Agreed Pretrial Order, and McKinney Grain did not present evidence at trial that would establish the applicability of the Act to the payments it received.

6. The Court, therefore, concludes that the Plaintiff's interest in the 2008 soybean and corn crops is superior to McKinney Grain's interest.

B. Claims Against McKinney Grain and the Debtors

7. The Plaintiff seeks a judgment against McKinney Grain and the Debtors based on alternative grounds of recovery – conversion and money had and received.

8. "Conversion is defined as the wrongful exercise of dominion and control over another's property in denial of or inconsistent with his rights." *Green Intern., Inc. v. Solis,* 951 S.W.2d 384, 391 (Tex. 1997). A party that benefits from proceeds subject to a lien or security interest may be liable for conversion of such proceeds if it has notice of the lien, and then accepts and benefits from the proceeds – good faith is not a defense in a suit seeking damages for conversion. *See Home Indem. Ins. v. Pate,* 814 S.W.2d 497, 498-99 (Tex. App. – Houston [1st Dist.] 1991, writ denied) (citing authority). Thus, to establish a claim for conversion in this case, the Plaintiff must prove that (1) it owned, possessed or had a right to immediate possession of the crops or the proceeds; (2) McKinney Grain or the Debtors wrongfully assumed and exercised dominion and control over the property inconsistent with the Plaintiff's rights; (3) McKinney Grain or the Debtors refused the Plaintiff's demand for the property, and (4) the Plaintiff suffered injury as a proximate result of a defendant' wrongful conduct. *See Edge Petroleum v. GPR Holdings,* 483 F.3d 292, 306 (5th Cir. 2007) (discussing conversion of a security interest under Texas law).

9. Generally, the measure of damages for conversion is the fair market value of the property at the time and place of the conversion. *See Prewitt v. Branham*, 643 S.W.2d 122, 123 (Tex. 1982). *See also Crocker National Bank v. Idesco,* 889 F.2d 1452, 1454 (5th Cir. 1989) (compensatory damages for conversion in Texas are measured by the market value of the property at the place and on the date of the conversion).

10. To recover on its money had and received claim, the Plaintiff must show that its personal property has been converted and turned into money or the equivalent of money.[2] *See, e.g., Staats v. Miller,* 243 S.W.2d 686, 687, 150 Tex. 581 (Tex. 1951) (plaintiff's action for money had and received was sustained when defendant lawfully came into possession of plaintiff's cotton harvester but wrongfully retained funds received as proceeds of authorized sale); *Gonzales Motor Co. v. Buhidar,* 348 S.W.2d 376, 378 (Tex. Civ. App. - Eastland 1961, ref. n.r.e.) (plaintiff entitled to judgment for money had and received against defendant who sold automobile wrongfully converted by finance company and delivered to defendant). A claim for money had and received, which is a form of "unjust enrichment," requires the plaintiff to show that the defendant holds money that in equity and good conscience belongs to the plaintiff. *See Best Buy v. Barrera,* 248 S.W.3d 160, 162-163 (Tex. 2007); *Everett v. TK-Taito, L.L.C.,* 178 S.W.3d 844, 860 (Tex. App. -- Fort Worth 2005, no pet.); *Miller-Rogaska, Inc. v. Bank One*, 931 S.W.2d 655, 662 (Tex. App. -- Dallas 1996, no writ).

11. Here, the Plaintiff had a security interest in the 2008 crops. The Debtors and McKinney Grain knew about the Plaintiff's security interest, and knew that the Plaintiff asserted that its interest had priority over that of McKinney Grain, before McKinney Grain harvested the 2008 crops. McKinney Grain nonetheless harvested the crops and retained the proceeds, including the proceeds of the insurance policy. McKinney Grain applied those monies to the outstanding debt owed by Hanging 4J Farms and the Debtors.

[2] A security interest is an interest in personal property or fixtures which secures payment or performance of an obligation. *See* TEX. BUS. & COM.CODE ANN. §§ 1.201; 9.102 (Vernon 2007).

12. The Court concludes the Plaintiff has established by a preponderance of the evidence that the Debtors and McKinney Grain converted its interest in the 2008 crops. The Court further concludes that the Debtors and McKinney Grain are jointly and severally liable to the Plaintiff for conversion. With respect to damages, McKinney Grain received the total amount of $100,860.18 as a result of the conversion of the 2008 crops according to the stipulations of the parties.

2. Prejudgment Interest

13. The Plaintiff requests an award of pre-judgment interest.

14. Pre-judgment interest is compensation allowed by law for the lost use of the money due as damages during the time between the accrual of the claim and the judgment date. *Johnson & Higgins, Inc. v. Kenneco Energy,* 962 S.W.2d 507, 528 (Tex. 1998). "There are two legal sources for an award of pre-judgment interest: (1) general principles of equity and (2) an enabling statute." *Id.* If no statute requires pre-judgment interest to be awarded, a court has the discretion to award pre-judgment interest if it determines an award is appropriate based on the facts of the case. *Cf. City of Port Isabel v. Shiba,* 976 S.W.2d 856, 860 (Tex. App. -- Corpus Christi 1998, pet. denied) (where no statute controls, decision to award prejudgment interest left to discretion of trial court); *Larcon Petroleum, Inc. v. Autotronic Sys.,* 576 S.W.2d 873, 879 (Tex. Civ. App. -- Houston [14th Dist.] 1979, no writ) (trial court may, but not is not required to, award pre-judgment interest under authority of statute or under equitable theory).

15. The Plaintiff has not cited the Court to any statute requiring this Court to award prejudgment interest under the facts of this case. In its post-trial brief, the Plaintiff

presents authority addressing the appropriate rate of pre-judgment interest in the event the Court makes such an award.

16. The actions of McKinney Grain and the Debtors were based on a good faith misunderstanding of current Texas law. Under the circumstances, the Court concludes that an award of pre-judgment interest would be inappropriate. Post-judgment interest will accrue on any judgment issued by this Court at the prevailing federal rate. *See* 28 U.S.C. § 1961.

C. Nondischargeability of Debtors' Obligation to the Plaintff

17. The Plaintiff argues that the debt arising from the Debtor's conversion of the 2008 crops is nondischargeable pursuant to 11 U.S.C. § 523(a)(6).

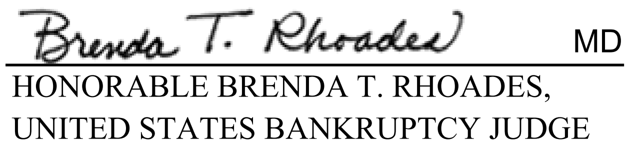
18. Section 523(a)(6) excepts from discharge any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." A willful and malicious injury is established under § 523(a)(6) when there exists either: (1) an objective substantial certainty of harm arising from a deliberate or intentional action or (2) there is a subjective motive to cause harm by a party taking a deliberate or intentional action. *See In re Keaty*, 397 F.3d 264, 271 (5th Cir. 2005); *In re Miller*, 156 F.3d 598, 603 (5th Cir. 1998). The objecting creditor bears the burden of proving nondischargeability by a preponderance of the evidence. *See, e.g., Everspring Enterprises, Inc. v. Wang (In re Wang)*, 247 B.R. 211, 213-14 (Bankr. E.D. Tex. 2000).

19. The tort of conversion does not necessarily involve an intentional injury that falls within § 523(a)(6). *See Kawaauhau v. Geiger,* 523 U.S. 57, 61 (1998); *National Union Fire Ins. Co. v. Care Flight Air Ambulance Serv., Inc.,* 18 F.3d 323, 325 (5th Cir. 1994). "[A] willful and malicious injury does not follow as of course from every act of

conversion, without reference to the circumstances. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice." *See Davis v. Aetna Acceptance Co.,* 293 U.S. 328, 331 (1934) (Cardozo, J.).

20. Upon considering the circumstances of this case, including the credible testimony of Dave James, the Court finds and concludes that the Debtors' conversion of the Plaintiff's interest in the 2008 crops was not willful or malicious. The Debtors acted in a good faith -- though mistaken -- belief that Texas law provided McKinney Grain with a superior interest in the 2008 crops. This mistake was understandable inasmuch as it appears that Texas law provided for such a priority in the past.

21. Any conclusion of law that is construed to be a finding of fact is hereby adopted as such.



HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE