UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

In re:
Case No. 03-4926-3F7
Chapter 7

BRUCE LEE JENNINGS,

Debtor.
_____/

GREGORY K. CREWS, as Chapter 7 Trustee
For the Estate of Bruce Lee Jennings,

Plaintiff,

vs.
Adv. No. 3:06-ap-84-PMG

QUARLES & BRADY, LLP,
QUARLES & BRADY LLP d/b/a
QUARLES & BRADY STREICH LANG LLP,
and NED NASHBAN,

Defendants.
_____/

ORDER ON MOTION FOR PARTIAL SUMMARY JUDGMENT

THIS CASE came before the Court for hearing to consider the Motion for Partial Summary Judgment filed by the Defendants, Quarles & Brady LLP, Quarles & Brady LLP d/b/a Quarles & Brady Streich Lang LLP, and Ned Nashban.

The Defendants are attorneys who represented Bruce Lee Jennings and ten related debtors in connection with the filing of their bankruptcy cases. The adversary proceeding currently before the Court is an action against the Defendants for legal malpractice and breach of fiduciary duty associated with the representations.

A primary issue in the adversary proceeding is whether the Defendants breached their duty of care to the bankruptcy estate of Bruce Lee Jennings (Jennings) by failing to seek adequate protection from a related debtor, B.L. Jennings, Inc., for Jennings' interest in the corporation's property.

In their Motion for Partial Summary Judgment, the Defendants contend that B.L. Jennings, Inc. never granted Jennings a security interest in any of its property, so that the Defendants' alleged failure to seek adequate protection from the corporation could not have caused any damage to Jennings' estate. (Doc. 69).

Background

The Debtor, Bruce Lee Jennings, founded B.L. Jennings, Inc. (BLJ) in 1985, and subsequently operated, managed, and controlled the company as its sole owner. BLJ is a Nevada corporation that was engaged in the business of distributing small caliber handguns and other firearms from its distribution facility in Carson City, Nevada. (Main Case, Docs. 8, 10).

Between January 23, 1997, and December 24, 2002, ten or more promissory notes (the Notes) were executed on behalf of BLJ and made payable to Jennings. The aggregate amount of the Notes exceeded $2,660,000.00. (Doc. 70, Exhibit 2). Each of the Notes was prepared on the same printed form, and provided that BLJ promised to pay Jennings the amount set forth in the respective Note, with interest, upon demand. Each Note also provided that it "shall be secured with a UCC-1 filing with the Secretary of State of Nevada." The Notes were signed by Chris Larsen as president of BLJ.

On December 4, 1998, a UCC-1 Financing Statement was filed with the Secretary of State of Nevada. (Doc. 70, Exhibit 3). According to the Financing Statement, the debtor was BLJ and the secured party was Jennings. The property covered by the Financing Statement was described as follows:

> Accounts receivable, all bank accounts at Wells Fargo Bank, checking acc# 0832516686 and market rate acc# 6832-667646, cash on hand, office equipment & computers & telephone equipment all aircrafts and autos, all firearms and inventory.

(Doc. 70, Exhibit 3). The Financing Statement was signed by Jennings individually, and as president of "Bruce Jennings."

Jennings, BLJ, and nine related debtors filed petitions under Chapter 11 of the Bankruptcy Code on May 14, 2003. The Defendants represented all of the debtors, including Jennings and BLJ, in connection with the filing of their bankruptcy cases.

Jennings filed his schedules on June 20, 2003. (Main Case, Doc. 35). On his schedule of assets, Jennings listed two accounts receivable owed to him by BLJ: (1) back payroll in the amount of $875,000.00, and (2) loans to BLJ in the amount of $2,000,000.00.

On June 23, 2003, BLJ filed its schedules. (Main Case, Doc. 43). On its schedule of liabilities, BLJ listed Jennings as a creditor holding a secured claim in the amount of $1,404,000.00. According to the schedules, the nature of the secured claim was a "personal loan" and a "UCC Filing in Nevada."

On February 25, 2004, the primary creditor in the Chapter 11 cases of Jennings and BLJ filed a Motion to Disqualify the Defendants as counsel for all of the related debtors. (Main Case, Doc. 423). The Motion to Disqualify was based on (1) the Defendants' representation of "multiple interests adverse to the estates" which they represented, and (2) their failure to properly disclose such conflicts. The creditor specifically alleged that the Defendants' representation of both BLJ and Jennings, as the holder of a lien on all of BLJ's assets, was an impermissible conflict.

On November 16, 2004, the Court entered its Findings of Fact and Conclusions of Law regarding the Motion to Disqualify. (Main Case, Doc. 889). With respect to Jennings' secured claim against BLJ, the Court found that the Defendants had failed to seek adequate protection from BLJ on behalf of Jennings' estate, and that BLJ's prepetition inventory had been sold and the proceeds consumed. (Main Case, Doc. 889, p. 6).

On May 13, 2005, the creditor filed a Complaint against the Defendants in the Circuit Court for Duval County, Florida. The Complaint contained two Counts: an action for legal malpractice, and an action for breach of fiduciary duty. In the Complaint, the creditor alleged, among other matters, that the Defendants had breached their duty to Jennings' bankruptcy estate by failing to seek adequate protection from BLJ for Jennings' secured claim against BLJ's property.

On June 7, 2005, shortly after the Complaint had been filed in state court, Jennings' Chapter 11 case was converted to a case under Chapter 7. (Doc. 1268).

The malpractice action that had been filed by the creditor in state court was subsequently transferred to the Bankruptcy Court, and the Trustee of Jennings' Chapter 7 estate was substituted for the creditor as the Plaintiff in the adversary proceeding.

On November 21, 2006, the Defendants filed their Motion for Partial Summary Judgment. (Doc. 69). In their Motion, the Defendants contend that BLJ never granted Jennings a security interest in any of its property, with the result that the Defendants' alleged failure to seek adequate protection from BLJ could not have caused any injury to Jennings' estate.

In response, the Trustee asserts that the Notes and the UCC-1 Financing Statement are sufficient to create a security interest under Nevada law, and that the Defendants' failure to seek adequate protection for the interest caused harm to Jennings' estate. (Doc. 82). Additionally, the Trustee asserts that the Defendants are precluded from challenging the security interest in this adversary proceeding, because they did not previously dispute the nature of the claim in the disqualification proceeding.

Discussion

The Defendants' Motion for Partial Summary Judgment and the Trustee's response to the Motion present two primary issues. First, the Court must consider whether the Defendants may challenge the validity of the security interest in the context of this malpractice action, even if the issue was not raised in the prior disqualification proceeding. Second, the Court must consider whether Jennings held a valid prepetition security interest in the assets of BLJ by virtue of the Notes and UCC-1 Financing Statement.

A. The Defendants' ability to challenge the security interest

The Trustee contends that the Defendants are prohibited from challenging the validity of Jennings' security interest in this adversary proceeding, because they had not challenged the enforceability of the security interest in the prior disqualification proceedings. According to the Trustee, the existence of the security interest was a key element in the disqualification proceedings, and the Court determined in those proceedings that BLJ's inventory was subject to a prepetition lien in favor of Jennings. Since the Defendants did not dispute the Court's finding, the Trustee asserts that they may not now challenge the existence or enforceability of the lien. (Docs. 134, 138).

The Court has evaluated the Trustee's assertion and finds that the Defendants are not prohibited from challenging the validity of Jennings' security interest in this adversary proceeding.

The Court entered its Findings of Fact and Conclusions of Law with respect to the creditor's Motion to Disqualify the Defendants on November 16, 2004. (Main Case, Doc. 889). It is clear from those Findings and Conclusions that the focus of the disqualification proceeding was whether the Defendants held any interest adverse to the estates which they represented, or were not disinterested, within the meaning of §327 of the Bankruptcy Code. A related issue in the disqualification proceeding was whether any potential conflicts were properly disclosed pursuant to Rule 2014 of the Federal Rules of Bankruptcy Procedure.

The Court ultimately determined that the Defendants were not disinterested, and that they had violated the disclosure requirements set forth in Rule 2014. The conclusion was based on the finding that the Defendants' simultaneous representation of Jennings, BLJ, and the other debtors involved conflicting or adverse interests. The disinterestedness arose in part from Jennings' claim against BLJ's prepetition assets.

In reaching its determination, however, it appears that the Court relied primarily, if not solely, on the schedules filed by Jennings and BLJ. The Court stated on page 10 of its Findings of Fact and Conclusions of Law, for example, that "B.L. Jennings' schedules indicate that Jennings holds a secured claim against B.L. Jennings for a loan to B.L. Jennings in the amount of $1,404,000.00." (Doc. 889, p. 10).

Clearly, the schedules filed by Jennings and BLJ were relevant to the determination of whether the Defendants' representation of both estates constituted an actual or potential conflict of interest, and were properly considered for that purpose. Generally, however, a debtor's schedules are not conclusive evidence as to the validity or enforceability of a scheduled claim. In In re Seibold, 351 B.R. 741 (Bankr. D. Idaho 2006), for example, the debtor represented on her schedules that a creditor held a lien on her vehicle. The Court found, however, that the scheduled claim was not sufficient to overcome the Uniform Commercial Code's requirements for an enforceable security interest. In re Seibold, 351 B.R. at 746 n. 4(citing In re Bannon, 92 I.B.C.R. 7, 8 (Bankr. D. Idaho 1992), which held that a debtor's schedules were insufficient evidence upon which to find that a security interest had been created, even if the debtor believed that a lien existed at the time that the schedules were filed.).

In this case, therefore, it appears that the Court's reference to BLJ's schedules was not intended to constitute an adjudication of the validity and enforceability of the lien, even though the Court's reliance on the schedules was appropriate for purposes of evaluating the conflict issues. In fact, the Court stated in its Findings of Fact and Conclusions of Law:

> Quarles & Brady may argue that the validity of Jennings' lien is questionable. (Tr. at 30). As representatives of Jennings' estate, they are obligated to fight for its validity; as representatives of B.L. Jennings' estate, they are obligated to argue against it. Quarles & Brady's argument underscores that it is not disinterested.

(Doc. 889, n. 4). The Court's statement is significant for several reasons. First, of course, it shows that the Defendants may have raised the issue of the lien's validity in the disqualification proceedings, at least on a preliminary basis. Second, it shows that the Court considered the scheduled security interest only for the purpose of evaluating the conflict issue, and not for the purpose of adjudicating the enforceability of the lien. Finally, contrary to the Trustee's suggestion that the Defendants had "every incentive" to challenge the security interest in the disqualification proceeding, the statement shows that such a challenge may actually have been inconsistent with the Defendants' interest in a proceeding that focused on conflicts between the estates.

In conclusion, the Court finds that the validity and enforceability of the scheduled security interest was not at issue in the disqualification proceedings, and that the Defendants are not prohibited from challenging the validity of the lien in this malpractice action.

B. The validity of the security interest

The second issue presented by the Defendants' Motion for Partial Summary Judgment and the Trustee's response is whether the Notes and UCC-1 Financing Statement created a valid security interest in the assets of BLJ. The Defendants contend that "BLJ never granted any security interest in any of its property to Bruce Jennings, so that the alleged failure of the Quarles & Brady Parties to seek adequate protection on behalf of the Bruce Jennings estate could not have caused damage to the Bruce Jennings estate." (Doc. 69, pp. 1-2).

The Defendants further contend that they are entitled to a partial summary judgment determining that their alleged failure to seek adequate protection did not

constitute a breach of their duty of care to Jennings' estate. (Doc. 69, pp. 8-9).

Pursuant to Rule 56(c) of the Federal Rules of Civil Procedure, as made applicable to this case by Rule 7056 of the Federal Rules of Bankruptcy Procedure, summary judgment is appropriate where the record shows that "there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c).

The parties appear to agree that the law of Nevada governs the issue of the validity and enforceability of the security interest in this case. (Doc. 69, p. 4; Doc. 82, p. 6). Nevada's version of the Uniform Commercial Code is found in Chapter 104 of the Nevada Revised Statutes.

In Nevada, a security interest is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation." N.R.S. 104.1201(2)(ii). Section 104.9203 of the Nevada Revised Statutes currently provides in part:

> **104.9203. Attachment and enforceability of security interest; proceeds; formal requisites; supporting obligations**
>
> 1. A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.
>
> 2. Except as otherwise provided in subsections 3 to 9, inclusive, a security agreement is enforceable against the debtor and third parties with respect to the collateral only if:
>
> (a) Value has been given;
>
> (b) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
>
> (c) One of the following conditions is met:
>
> (1) The debtor has authenticated a security agreement that provides a description of the collateral .
> . . .

N.R.S. 104.9203(Emphasis supplied). Under the Nevada Revised Statutes, a "security agreement" is defined as "an agreement that creates or provides for a security interest." N.R.S. 104.9102(ttt). To "authenticate" a security agreement includes the signing of the agreement. N.R.S. 104.9102(g).

The Nevada Revised Statutes quoted above are effective as of July 1, 2001. N.R.S. 104.9703. Prior to July 1, 2001, it appears that Nevada law provided that a security interest attached when "there is (1) an agreement that it attach, (2) value is given, and (3) the debtor has rights in the collateral." May v. G.M.B., Inc., 105 Nev. 446, 450, 778 P.2d 424, 426 (Nev. 1989)(citing McCorquodale v. Holiday, Inc., 90 Nev. 67, 69, 518 P.2d 1097, 1098 (Nev. 1974)(citing former N.R.S. 104.9204). For a security interest to attach under these provisions, Courts generally found that the documents submitted to establish the claim must "contain language creating a security interest." McCorquodale, 90 Nev. at 69, 518 P.2d at 1098; Love v. Wells, 96 Nev. 12, 13 604 P.2d 362 (Nev. 1980).

The UCC-1 Financing Statement and at least seven of the Notes at issue in this case were signed before July 1, 2001. At least three other Notes were signed after July 1, 2001.

Regardless whether the Court looks to the current statute or the pre-2001 cases, however, it appears that the key issue is whether the Notes and UCC-1 Financing Statement constitute an agreement that created or provided for a security interest in BLJ's property.

The Court has considered the record, and cannot determine as a matter of law that the documents did not create or provide for a security interest in BLJ's property. Consequently, the Defendants' Motion for Partial Summary Judgment should be denied.

In reaching this determination, the Court has considered the analysis set forth in In re Schwalb, 347 B.R. 726 (Bankr. D. Nev. 2006). In Schwalb, the issue was whether a pawnbroker ticket was an agreement to create or provide for a security interest under Nevada law. In re Schwalb, 347 B.R. at 740. Even though the ticket contained the language "you are giving a security interest in the following property," the debtor in that case asserted that the ticket was legally insufficient as a security agreement. Id. at 741-42. The Court concluded that the

ticket was an agreement that created or provided for a security interest. Id. at 742.

Under Nevada law, an "agreement" is defined as "the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in NRS 104.1303." N.R.S. 104.1201.2(c). A "security agreement" is defined as "an agreement that creates or provides for a security interest." N.R.S. 104.9102(ttt).

As discussed in Schwalb, however, no specific language is prescribed to "create" or "provide for" the security interest.

> The insistence on formal words of grant or transfer is inconsistent with the structure and intent of Article 9. As the Idaho Supreme Court noted with respect to the original version of Article 9:
>
> > Courts have often repeated that no magic words are necessary to create a security interest and that the agreement itself need not even contain the term "security interest." This is in keeping with the policy of the code that form should not prevail over substance and that, whenever possible, effect should be given to the parties' intent.
>
> (Citations omitted.) The proper policy considerations are well stated by a leading commentator on Article 9: "There is no requirement for words of grant. In fact, such a requirement smacks of the antiquated formalism the drafters were trying to avoid." 1 CLARK & CLARK, *supra*, at ¶ 2.02[1][c], at p. 2-16. *See also* 4 WHITE & SUMMERS, *supra*, at §31-3 ("the drafters did not intend that specific 'words of grant' be required.").

In re Schwalb, 347 B.R. at 742-43. No specific language is required to create a security interest. The absence of such a requirement is reflected in the scope of the article governing secured transactions. The article applies to any "transaction, regardless of form, that creates a security interest in personal property or fixtures by contract." N.R.S. 104.9109.1(a)(Emphasis supplied). As set forth in the Comments to §104.9109, the article applies "regardless of the form of the transaction or the name that parties have given to it," provided a security interest is created. N.R.S. 104.9109, Comment 2.

In this case, copies of ten Notes appear in the record. The Notes each provide that, for "value received," BLJ promised to pay Jennings the amount set forth in the respective Note, with interest, upon demand. Each Note also provides that it "shall be secured with a UCC-1 filing with the Secretary of State of Nevada." The Notes were signed by an individual named Chris Larsen as president of BLJ. Chris Larsen is identified in BLJ's Statement of Financial Affairs as its president, and is identified in BLJ's first day motions as a member of its on-site management team. (BLJ Main Case, Docs. 14, 44).

Consistent with the language in the Notes that the indebtedness "shall be secured with a UCC-1 filing," a UCC-1 Financing Statement was in fact filed with the Secretary of State of Nevada on December 4, 1998, after two Notes had been signed. The UCC-1 Financing Statement identifies B.L. Jennings, Inc. of Carson City, Nevada as the debtor, and Bruce Lee Jennings as the secured party. The UCC-1 also contains a description of the property covered by the Financing Statement. The covered property includes accounts receivable, certain bank accounts identified by bank and account number, cash, equipment, and firearms and inventory.

In other words, the Notes and UCC-1 Financing Statement indicate that BLJ had agreed to pay money to Jennings upon specific terms, and that the indebtedness was for "value received." The documents clearly identify BLJ as the debtor and Jennings as the lender, and state that the obligation "shall be secured with a UCC-1 filing." The Financing Statement was filed in the public records, pursuant to the Notes, and the Financing Statement contains a description of BLJ's property that served as collateral for the indebtedness.

The Notes and the Financing Statement, construed together, may be sufficient to establish a security interest in BLJ's property. See In re Weir-Penn, Inc., 344 B.R. 791, 794 (Bankr. N.D. W. Va. 2006)(a note and financing statement created a security interest, even in the absence of a separate security agreement); In re Hite, 4 B.R. 547, 549 (Bankr. N.D. Ohio 1980)("a financing statement, attended by other documents or circumstances, may suffice as a valid security agreement"); and Dickason v. Marine National Bank of Naples, N.A., 898 So.2d 1170, 1174 (Fla. 2d DCA 2005)("Nothing in the UCC prohibits

parties from integrating several documents to create a security agreement.").

Under these circumstances, the Court cannot determine as a matter of law that the documents do not constitute an agreement that created or provided for a security interest in BLJ's property.

As a final matter, the Defendants contend that the documents do not effectively create a security interest because the UCC-1 Financing Statement is not signed by the debtor. The signature of Bruce Lee Jennings appears on the Financing Statement, both in his individual capacity and as president of "Bruce Jennings." The corporate name, B.L. Jennings, Inc., does not appear in the signature block of the document.

The name of the corporation, B.L. Jennings, Inc., however, is typed on the UCC-1 Financing Statement as the debtor in the transaction. A federal tax number and street address for BLJ are also typed on the form. According to the Trustee, the corporate records reflect that Jennings was the president, secretary, and treasurer of BLJ at the time that the UCC-1 Financing Statement was filed. (Doc. 137, p. 2 and Exhibits A and B). In other words, BLJ is identified on the face of the document as the debtor, and Jennings was the president of BLJ at the time that he signed the document. For purposes of the Defendants' Motion for Partial Summary Judgment, therefore, the Court cannot determine as a matter of law that the UCC-1 Financing Statement was not signed by BLJ. In re Rebecca A. Knight, M.D., S.C., 2006 WL 3147714, at 5-6 (Bankr. C.D. Ill.); In re Ballard, 100 B.R. 526, 529-30 (Bankr. D. Nev. 1989).

Conclusion

In their Motion for Partial Summary Judgment, the Defendants assert that BLJ never granted Jennings a security interest in any of its property, with the result that the Defendants' alleged failure to seek adequate protection from the corporation could not have caused any damage to Jennings' estate. Consequently, the Defendants contend that the alleged failure did not constitute a breach of their duty of care to Jennings' estate in the bankruptcy case.

The validity or enforceability of the security interest was not at issue in the prior disqualification proceedings, and the prior proceedings do not preclude the Defendants from challenging the validity of the security interest in this malpractice action.

The Court cannot determine as a matter of law, however, that the Notes and UCC-1 Financing Statement did not create or provide for a security interest in BLJ's property. No specific form or language is required to create a security interest, and the Notes and UCC-1 Financing Statement appear to reflect an indebtedness, an agreement that the debt "shall be secured," and a description of the property subject to the agreement.

Accordingly:

IT IS ORDERED that the Motion for Partial Summary Judgment filed by the Defendants, Quarles & Brady LLP, Quarles & Brady LLP d/b/a Quarles & Brady Streich Lang LLP, and Ned Nashban, is denied.

DATED this 18th day of May, 2009.

BY THE COURT

/s/Paul M. Glenn
PAUL M. GLENN
Chief Bankruptcy Judge