

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE  
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 97-35040

LOVING HOMES, INC.

Debtor

J. W. LEE, Individually, and JAMES W. LEE,  
as Executor of the Last Will and Testament of  
LORRAINE N. LEE, DECEASED

Plaintiffs

v.

Adv. Proc. No. 98-3089

LOVING HOMES, INC.,  
FIRST STATE BANK, and  
ANN MOSTOLLER, TRUSTEE

Defendants

and

ANN MOSTOLLER, TRUSTEE

Third-Party Plaintiff

v.

PEOPLES EXCHANGE BANK

Third-Party Defendant

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**MEMORANDUM**

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**RICHARD STAIR, JR.**  
**UNITED STATES BANKRUPTCY JUDGE**

J. W. Lee commenced this adversary proceeding against the Debtor, Loving Homes, Inc., and First State Bank on August 6, 1998, by filing a Complaint to Determine Validity of Secured Claim, To Lift Automatic Stay, and To Turnover Proceeds. On August 19, 1998, Mr. Lee filed an Amended Complaint to Determine Validity of Secured Claim and to Turn Over Proceeds. A Second Amended Complaint to Determine Validity of Secured Claim and to Turn Over Proceeds filed on August 28, 1998, joined the Chapter 7 Trustee, Ann Mostoller, as a party defendant. The Debtor was dismissed as a party defendant by agreement of the parties pursuant to the Pre-Trial Order entered on March 16, 1999, and James W. Lee, Executor of the Estate of Lorraine N. Lee, was added as a party plaintiff.<sup>1</sup> The Plaintiffs' action relates to ten mobile homes manufactured by the Debtor in which they assert a security interest.<sup>2</sup>

Pursuant to the Consent of Plaintiff to Consolidation filed December 11, 1998, this adversary proceeding was consolidated with the Objection to Claim filed by the Trustee in the Debtor's case on December 2, 1998, objecting to the allowance of the claim of J. W. Lee and Lorraine Lee filed January 8, 1998, as a secured claim in the amount of \$100,000.00. In addition, the Trustee filed a Third-Party Complaint Against People's [sic] Exchange Bank on February 17, 1999, seeking a determination of the Third-Party Defendant's interest in the disputed mobile homes. The Trustee and Peoples Exchange Bank filed an Agreed Order of Settlement with Peoples Exchange Bank on April 2, 1999, under which they agreed that Peoples Exchange Bank's

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<sup>1</sup> Lorraine N. Lee, the wife of J. W. Lee, was a party to the events described herein involving the Debtor. Mrs. Lee is now deceased and her estate has succeeded to her interest. References in this Memorandum to the "Plaintiffs" are references to J. W. Lee and Lorraine Lee, individually.

<sup>2</sup> To the extent that the original complaint requested relief from the automatic stay, it was dismissed by the court sua sponte pursuant to an Order entered on August 12, 1998, without prejudice to file an appropriate motion in the Debtor's case.

interest in the mobile homes is subordinate to the interests of the Plaintiffs and First State Bank and that its interest would be subordinated to that of the Trustee, should the Trustee avoid the Plaintiffs' lien.<sup>3</sup>

All issues have been fully briefed and were tried on February 1, 2000. Plaintiff J. W. Lee testified and seventeen exhibits were admitted into evidence, thirteen of which were compiled in a Stipulation of Facts and Documents filed on June 17, 1999.<sup>4</sup>

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(K) (West 1993).

## I

On August 9, 1995, the Debtor borrowed \$100,000.00 from J. W. Lee and Lorraine Lee for use as operating capital for the production of mobile homes. In exchange, the Debtor executed a Note in favor of the Lees in the amount of \$100,000.00. The entire principal amount of the Note plus interest and attorney's fees remains unpaid. On the same date, the Debtor and the Lees executed a Contract and Security Agreement. Article IV of the Contract and Security Agreement provides in material part:

It is agreed by the parties hereto that the Lenders [Plaintiffs] shall by appropriate documentation be guaranteed security for their loan on each mobile

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<sup>3</sup> The Trustee does not seek to avoid the Plaintiffs' lien through the present action. Her objection to the Lees' claim is grounded on a lack of documentation sufficient to support the claim as secured.

<sup>4</sup> This adversary proceeding and the Trustee's objection to the Plaintiffs' claim filed in the Debtor's case were initially resolved by a Judgment and Order, respectively, entered on August 20, 1999. At that time, all issues had been presented to the court solely on the basis of the parties' June 17, 1999 Stipulation of Facts and Documents. However, on November 15, 1999, the court granted the Plaintiffs' Motion for New Trial or in the Alternative, Motion to Alter or Amend Judgment filed on August 30, 1999, and vacated the August 20, 1999 Judgment and Order. The present Memorandum supersedes the Memorandum filed contemporaneously with the August 20, 1999 Judgment and Order.

home that is produced from the proceeds of this loan or any addition or extension hereto. The Lenders shall be furnished documentation of security, as above provided, on at least ten (10) mobile homes so long as the principal of the loan remains at the \$100,000.00 level. Should the principal of the loan be reduced or extended, the number of units securing this loan shall be reduced or extended at the rate of \$10,000.00 per unit for each \$10,000.00 reduction of principal or the substitution of another mobile home unit in production. The Lenders shall immediately release one (1) mobile home unit from the UCC 1 Security Agreement.

It is agreed that the parties will maintain a duplicate record by serial number of each mobile home unit covered by this Security Agreement containing a release line for the acknowledgement [sic] of satisfaction of the loan on the particular numbered unit.

Article V of the Contract and Security Agreement provides:

The Borrower shall execute and deliver UCC 1 Financial Statements covering the appropriate single wide production of the LaFollette Plant at the same level as defined in Article IV of this agreement.

The Plaintiffs filed a financing statement on August 15, 1995, which identifies their collateral as “[a] portion of the single wide mobile home production of Loving Homes, Inc. including work in progress and designated mobile home units as completed.”

First State Bank (the Bank) loaned funds to the Debtor in August 1995 in the amount of \$200,465.28. It filed a financing statement on August 28, 1995, which identifies its collateral as “[a]ll accounts receivable, inventory, furniture & fixtures and equipment now owned or hereafter acquired.”

The Plaintiffs and the Debtor executed an Amendment to the August 9, 1995 Contract and Security Agreement on March 7, 1996. Under the Amendment, the parties agreed, in material part, that:

- (1) The security for the indebtedness described in the Agreement shall consist of: A portion of the single wide mobile home production of Loving Homes, Inc. consisting of designated fully finished and completed mobile home units for which Lenders have advanced loans.
- (2) Lenders and Borrower shall execute and deliver UCC-3 financing statements to reflect the provisions of paragraph 1.
- . . . .
- (4) The Agreement is amended as described herein and otherwise remains in full force and effect.

On March 15, 1996, the Plaintiffs filed a UCC-3 financing statement to amend the August 15, 1995 financing statement in order to release their security interest in “[w]ork in progress.” The August 15, 1995 financing statement was further amended by another UCC-3 financing statement also filed on March 15, 1996, which provides that “[t]he Secured Party’s financing statement covers the following types or items of property: A portion of the single wide mobile home production of Loving Homes, Inc. consisting of designated fully finished and completed mobile home units for which Secured Party has advanced loans.”

The next year, the Debtor obtained more financing from the Bank. On January 24, 1997, the Bank entered into a Floor Plan Finance Agreement with the Debtor, granting the Debtor a \$500,000.00 line of credit. The Debtor executed a promissory note and security agreement in favor of the Bank on or about that same date. On February 6, 1997, the Bank filed a financing statement evidencing its security interest, which included an interest in new mobile home units located at 3259 Appalachian Highway, Jacksboro, Tennessee.

At trial, J. W. Lee testified about the Plaintiffs' loan to the Debtor and the parties' actions regarding the mobile homes which, he contends, secured that loan. He testified that he did not know how the proceeds of the Plaintiffs' \$100,000.00 were used; that on the same day that he made the loan he received a list of ten completed mobile homes; that he believed that the mobile homes would secure the loan under the Contract and Security Agreement; that when the mobile homes on that list were sold he would sign releases of his interest in them; that immediately upon signing the release he would receive documentation that the released homes had been replaced with other completed mobile homes identified by serial number; that he understood that the replacement mobile homes secured the Plaintiffs' loan under the Contract and Security Agreement and the Amendment; and that every month the Debtor would give him a list of mobile homes, identified by serial number, which were designated as collateral for the Plaintiffs' loan.

In addition, the January 10, 2000 Telephonic Deposition of Terry Loving, the Debtor's president, was admitted into evidence at trial. Therein, Terry Loving testified that the Debtor received the Plaintiffs' loan in one payment; that he deposited all of the loan proceeds into the Debtor's general account; that the loan was used for operating expenses, specifically, supplies and payroll; and that he was not aware of the loan being used for any other purpose. In addition, he testified that he understood that under the Contract and Security Agreement and under the Amendment the Plaintiffs would have a security interest in mobile homes that were either finished or still in production.

On November 4, 1997, the Debtor provided the Plaintiffs with a revised list of ten mobile homes. It is in those ten listed mobile homes that the Plaintiffs assert a security interest. The list



consists of a chart entitled “LOVING HOMES, INC. INVENTORY LOG” (Inventory Log) which provides eight categories of information for each unit. One category identifies the serial numbers of the ten units as follows: 1, 203, 222, 554, 622, 649, 692, 734, 804, and 905. Another category is entitled “DATE OFFLINE.” Eight of the ten units have a “DATE OFFLINE” after March 7, 1996, and two, serial numbers 1 and 203, have a “DATE OFFLINE” prior to March 7, 1996. Another category, “CURRENT LOCATION,” designates “LOWER LOT” as the location for two of the units, numbers 1 and 222, and “GRIMMS” is the location listed for the other eight. In addition, the chart recites that each of the ten units was “FLOORED THRU . . . JWL.” The terms “DATE OFFLINE,” “GRIMMS,” “LOWER LOT,” and “FLOORED THRU . . . JWL” are not defined on the Inventory Log or in the Stipulation of Facts and Documents filed by the parties.<sup>5</sup>

On November 17, 1997, the Debtor provided the Plaintiffs with a revised list of mobile homes dated November 14, 1997. Because only three of the units on that list were completed, the Plaintiffs rejected that list as a replacement of the November 4, 1997 list. Also on November 17, 1997, the Bank declared that the Debtor’s line of credit was in default. It repossessed ten mobile home units then located at 3259 Appalachian Highway, Jacksboro, Tennessee. Three of those units, serial numbers 649, 734, and 905, had been included in the November 4, 1997 list provided to the Plaintiffs.

The Debtor filed its petition under Chapter 11 on November 21, 1997. At the direction of the Debtor, the Plaintiffs took possession of five mobile home units which were included in the

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<sup>5</sup> The parties stipulate that all of the Debtor’s mobile homes were produced at its plant in LaFollette.

November 4, 1997 list, serial numbers 1, 203, 554, 622, and 692.<sup>6</sup> They have not sold those units.

The Bank requested relief from the automatic stay with respect to the three mobile home units from the November 4, 1997 list in its possession. The parties agree that the court's proceeding memo from the hearing on that motion indicates that an agreed order would be entered to permit the Bank to sell the units and place the proceeds in escrow pending an agreement with regard to its distribution. No such order was entered. Nonetheless, the Bank sold the three mobile home units on June 25, 1998, for a total amount of \$42,000.00. The Plaintiffs have not received any of the proceeds of that sale. On August 6, 1998, the Plaintiffs filed this adversary proceeding to determine the validity of their security interest in the mobile home units appearing on the November 4, 1997 list and for turnover of the proceeds from the sale of three of those mobile homes by the Bank.

The Debtor's case was converted to a case under Chapter 7 on August 19, 1998, and Ann Mostoller was appointed trustee. On December 2, 1998, the Trustee filed an Objection to Claim in the Debtor's case objecting to a secured claim filed by the Plaintiffs. The Trustee objects to the claim on the grounds that the documentation supporting the claim does not establish the Plaintiffs' secured status. On December 11, 1998, the Plaintiffs filed a Consent of Plaintiff to Consolidation in order to consolidate the Trustee's Objection to Claim and this adversary proceeding.

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<sup>6</sup> Of the ten units on the November 4, 1997 list, the parties can account only for the three units repossessed by the Bank and the five possessed by the Plaintiffs. The other two units, serial numbers 222 and 804, have not been located.

There are two issues before the court.<sup>7</sup> The first is whether the Plaintiffs have a perfected security interest in any of the mobile homes on the November 4, 1997 list. The second is whether the Plaintiffs' security interest is superior to that of First State Bank and the bankruptcy estate.

## II

Under Tennessee law, the security agreement creates the security interest and is the basic contract between the parties with respect to the security interest. See TENN. CODE ANN. § 47-9-105(l) (1996);<sup>8</sup> *H & I Pipe and Supply Co., Inc. v. First Nat'l Bank of Crossville (In re H & I Pipe and Supply Co., Inc.)*, 44 B.R. 949, 951 (Bankr. M.D. Tenn. 1984). The security interest is not enforceable against a debtor or third party until it has attached to the collateral. See TENN. CODE ANN. § 47-9-203(1) (1996).<sup>9</sup> Attachment is complete when the following requirements are met: "(a) . . . the debtor has signed a security agreement which contains a description of the collateral . . .; and (b) the value has been given; and (c) the debtor has rights in the collateral." *Id.*

In the present matter, the Debtor signed a security agreement and amendment containing descriptions of collateral, and the parties do not question that value was given or that the Debtor had rights in the property at issue. The issue remaining under § 47-9-203(1) is whether the

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<sup>7</sup> These issues are set forth in the Pre-Trial Order submitted by the parties which was entered by the court on March 16, 1999.

<sup>8</sup> This citation is to Tennessee's version of the Uniform Commercial Code in effect prior to the 1997 and 1998 amendments. Although the amendments did not change the statute with regard to the issues raised in the Plaintiffs' action, it is the pre-amendment version that controls this matter. See TENN. CODE ANN. § 47-9-105(l) (Supp. 1999).

<sup>9</sup> See *supra* note 8. See TENN. CODE ANN. § 47-9-203(1) (Supp. 1999).

property at issue is covered by the security agreement and its amendment, or, more specifically, whether the ten mobile homes are within the scope of the description of collateral contained in those agreements.

### III

When determining the extent of a security interest, courts may consider the security agreement and any documents to which it refers. *See H & I Pipe and Supply Co.*, 44 B.R. at 950. The language describing the property to be covered by the Plaintiffs' alleged security interest appears in Article IV and Article V of the Contract and Security Agreement executed by the Plaintiffs and Debtor on August 9, 1995, and in the March 7, 1996 Amendment to the Contract and Security Agreement. Together, those documents describe the collateral as consisting of mobile homes that were produced from the proceeds of the Plaintiffs' loan. That description of the collateral is agreed upon in Article IV of the Contract and Security Agreement, which provides in part that "the Lenders shall by appropriate documentation be guaranteed security for their loan on each mobile home *that is produced from the proceeds of this loan . . .*" (emphasis added). The Amendment continues that description, although rephrased, by using the words "for which Lenders have advanced loans." The description of the collateral is further evidenced by the financing statement, as amended by the UCC-3 filings after execution of the Amendment, which covers "mobile home units for which Secured Party has advanced loans."

The analysis for determining whether a security agreement covers property claimed as collateral under § 9-203 of the Uniform Commercial Code, adopted in Tennessee at § 47-9-203, has been explained as a two-step inquiry:

In their treatise on the Uniform Commercial Code, James White and Robert Summers set forth a two-fold inquiry for determining whether a particular item is within the scope of a security agreement. The first element to be satisfied is whether the writing, under the broadest interpretation possible, might objectively be read as potentially including the property claimed. The second aspect of the inquiry is whether the parties to the agreement intended for the property to be collateral within the scope of the agreement.

*Bavely v. Wandstrat (In re Harbour Lights Marina, Inc.)*, 146 B.R. 963, 969 (Bankr. S.D. Ohio 1992), *aff'd* 153 B.R. 781 (S.D. Ohio 1993) (citing JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 22-4, at 974 (3d ed. 1988)) (finding no security interest in property where only one element was satisfied).

In order to prevail, the Plaintiffs must first show that the description of their collateral contained in the Contract and Security Agreement and in the Amendment, “under the broadest interpretation possible, might objectively be read as potentially including the property claimed.” *Id.* They must demonstrate that it is possible that the language “the Lenders shall by appropriate documentation be guaranteed security for their loan on each mobile home that is produced from the proceeds of this loan . . . ” and “for which Lenders have advanced loans” could objectively include the ten mobile homes on the November 4, 1997 list.

The Plaintiffs have not established that the mobile homes on the November 4, 1997 list are or could possibly be the collateral described in the loan documents. First, the deposition testimony of Terry Loving establishes that all of the proceeds of the Plaintiffs’ loan were deposited into the

Debtor's general operations account and were spent on payroll and supplies. No connection has been made between those expenditures and the ten mobile homes. Second, the testimony of J. W. Lee establishes that on the day that the Plaintiffs made the loan they received a list of ten fully completed mobile homes which were intended to secure their loan. Thus, from the first list, there was no connection between the supposed collateral and the production accomplished with the proceeds of the Plaintiffs' loan. Third, the testimony of J. W. Lee establishes that as the homes were sold the Plaintiffs would receive documentation reflecting that other mobile homes had been substituted for homes on that list. The facts do not establish that any mobile home on the initial list or any subsequent list was produced with the proceeds of the Plaintiffs' loan. To the contrary, the testimonies of Terry Loving and J. W. Lee demonstrate that the mobile homes on the November 4, 1997 list were not produced with the proceeds of the Plaintiffs' August 9, 1995 loan. Further, the Plaintiffs do not attempt to explain how such a connection would be possible.

In summary, under the Contract and Security Agreement and the Amendment, the only collateral to which the Plaintiffs' alleged security interest could attach are those mobile homes that were produced with the proceeds of their loan. The Plaintiffs have failed to establish that the mobile homes on the November 4, 1997 list, or any of the mobile homes produced by the Debtor, were produced with the proceeds of their loan. Therefore, the court must find that the Plaintiffs' alleged security interest could not have attached to the mobile homes at issue and that they do not have an enforceable security interest in those mobile homes under TENN. CODE ANN. § 47-9-203(1).

#### **IV**

The Plaintiffs argue that the Contract and Security Agreement and Amendment clearly contemplate that the Plaintiffs would release their alleged security interest in the collateral and receive documentation of replacement collateral. This argument attempts to bypass, under the guise of the release and replacement provisions, the Plaintiffs' inability to establish that the mobile homes on the November 4, 1997 list were produced with the proceeds of the Plaintiffs' loan. This approach, however, gains nothing for the Plaintiffs because the release and replacement provisions of the documents are necessarily subject to the provisions in the Contract and Security Agreement and Amendment that describe the collateral. In other words, the release and replacement provisions merely allow the Plaintiffs to release their security interest in collateral which meets the description and replace it with other collateral which also meets the description. Thus, the release and replacement provisions do not change the fact that the mobile homes at issue simply are not covered by the security interest that the Plaintiffs attempted to create in the Contract and Security Agreement and under the Amendment.

#### **V**

The mobile homes at issue are not the collateral described in the Contract and Security Agreement and in the Amendment. Thus, the Plaintiffs' alleged security interest under those documents did not attach to the mobile homes at issue and is unenforceable against the Debtor and third parties. See TENN. CODE ANN. § 47-9-203(1).

For the above reasons, the court concludes that the Plaintiffs do not have a security interest in the ten mobile homes in dispute in this adversary proceeding and that the interests of the Trustee and the Bank in these mobile homes are superior to the interest of the Plaintiffs.<sup>10</sup>

An appropriate judgment will be entered. An order will be entered in the Debtor's case sustaining the Trustee's objection to the claim of J. W. Lee and Lorraine Lee. The Lees' claim will be disallowed as secured but will be allowed in its entirety as a nonpriority unsecured claim.

FILED: February 28, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE

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<sup>10</sup> The Trustee makes no claim in this adversary proceeding that her interest in the mobile homes and their proceeds is superior to the interest of the Bank.



**IN THE UNITED STATES BANKRUPTCY COURT FOR THE  
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 97-35040

LOVING HOMES, INC.

Debtor

**ORDER**

For the reasons stated in the Memorandum filed this date containing findings of fact and conclusions of law as required by FED. R. CIV. P. 52(a), the court directs the following:

1. The Objection to Claim filed by Ann Mostoller, Trustee, on December 2, 1998, objecting to the allowance of the claim of J. W. Lee and Lorraine Lee filed as secured in the amount of \$100,000.00 is SUSTAINED.
2. The claim of J. W. Lee and Lorraine Lee is disallowed as secured but is allowed in the amount filed as a nonpriority unsecured claim.

SO ORDERED.

ENTER: February 28, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE

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Third-Party Plaintiff

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PEOPLES EXCHANGE BANK

Third-Party Defendant

**J U D G M E N T**

For the reasons set forth in the Memorandum filed this date containing findings of fact and conclusions of law as required by FED. R. CIV. P. 52(a), it is ORDERED, ADJUDGED, and DECREED as follows:

1. The Plaintiffs do not have a security interest in the ten mobile homes which are the subject of this adversary proceeding.

2. The interests of the Defendants First State Bank and Ann Mostoller, Trustee, in the ten disputed mobile homes and in the proceeds derived from the sale of the mobile homes are superior to the interest of the Plaintiffs.

ENTER: February 28, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE