

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
H.J. RUF LAND & CATTLE CO.,) CASE NO. BK92-81348
)
DEBTOR) CH. 12
) Fil. No. 79 & 87

MEMORANDUM

Hearing was held on January 12, 1994, on the Motion by Farm Credit Bank of Omaha for sequestration of rents and profits and debtor's resistance. Appearing on behalf of debtor was Eric Wood of Omaha, Nebraska. Appearing on behalf of Farm Credit Bank (FCB) was James McClymont and James Baumann of North Platte, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A), (K) and (M).

Background

This Chapter 12 farm case was filed in 1992. The FCB filed a motion for sequestration of rents and profits on December 10, 1993. The FCB is owed approximately \$624,000.00 as of the date of the hearing without computation of interest, attorney's fees or other costs since the date of filing. There are prepetition real estate taxes in the approximate amount of \$90,000.00 which, under state law, are liens with priority over the lien interest of the FCB. The FCB is the holder of notes, mortgages and deeds of trust which contain an assignment of "rents and profits."

By separate order, this Court has determined that the value of the property is less than the amount due for real estate taxes and the FCB note. In other words, the FCB is undersecured.

The case law in this jurisdiction requires that before a lender is entitled to an order from the Court sequestering rents and profits, the creditor must show that there has been a prepetition default by the debtor, that the creditor is in an undersecured position and that the creditor has a perfected security interest in rents and profits. In re Selden, 62 B.R. 954 (Bankr. D. Neb. 1986); Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987). This Court also requires a showing that the

FCB has provided notice of the debtor's restructuring rights to the debtor as required by the Agricultural Credit Act of 1987.

The evidence before the Court is that there was a prepetition default by the debtor; the creditor is in an undersecured position; the FCB has given notice of the debtor's restructuring rights to the debtor. The remaining element is whether FCB has a perfected security interest in rents and profits.

Security Interest in "Rents and Profits"

The FCB suggests that it has a perfected security interest in "rents and profits" by virtue of Section 552(b) of the Bankruptcy Code. That section permits a continuation of prepetition perfected interests in "rents or profits" acquired by the estate after the commencement of the case to the extent provided by the security agreement and by applicable non-bankruptcy law. 11 U.S.C. § 552(b) (1993). The FCB further suggests that if affirmative action was required to enforce its assignment of rents and profits clause in the mortgage and trust deeds, the filing of the Motion for Sequestration was such affirmative action.

As authority for such a position, the FCB relies upon federal cases such as Butner v. United States, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed.2d 136 (1979), Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987), and In re Anderson, 50 B.R. 728 (D. Neb. 1985), all of which discuss the right of a creditor in bankruptcy to perfect an unperfected prepetition lien in "rents and profits" after the bankruptcy petition is filed. In addition to the federal cases, the FCB relies upon cases interpreting Nebraska law concerning the right of a creditor to collect rents and profits from mortgaged lands upon default by the debtor. See Center Sav. Bank v. First Cadco Corp., 186 Neb. 112, 114, 181 N.W.2d 261, 264 (1970); Penn Mut. Life Ins. Co. v. Katz, 139 Neb. 501, 504, 297 N.W. 899, 901 (1941); Prudential Ins. Co. v. Farm Inv. Co., 123 Neb. 578, 586, 243 N.W. 842, 846 (1932); Huston v. Canfield, 57 Neb. 345, 346, 77 N.W. 763, 764 (1899).

The problem with the reliance by the FCB on these cases is that with the exception of Mahloch each of the cases dealt solely with rents which were earned pursuant to a lease of the real property.¹ Although the language used in the cases frequently

¹ This judge was the trial judge in the bankruptcy court who decided In re Mahloch, 62 B.R. 744 (Bankr. D. Neb. 1986), aff'd 160 B.R. 369 (D. Neb. 1986), aff'd in part and rev'd in

lumps the term "rents" and the term "profits" together, as if they were the same type of item, none of the cases actually deal with or analyze the term "profits" which, at common law, included products of the land. Equitable Life Ins. Co. v. Brown, 220 Iowa 585, 262 N.W. 124, 127 (1935); Gisborn v. Charter Oak Life Ins. Co., 142 U.S. 326, 335-36, 12 S. Ct. 277, 35 L. Ed. 1029 (1892); John C. Minahan, Jr., Rents and Profits in Bankruptcy: A Nebraska Primer and Consideration of L.B. 14, 27 **Creighton L. Rev.** 158, 173 (1993).

The Eighth Circuit decision in Mahloch dealt with "profits" only to the extent that the funds on hand which were the subject of the motion to sequester were identified by the parties as "rents and profits." The analysis by the Eighth Circuit ignored the fact that although earnings from the use of the land under common law were frequently deemed to be "profits" and accrued to the benefit of the party holding a mortgage interest in the land and an assignment of "profits," under modern statutes such as the Uniform Commercial Code, which is in effect in Nebraska, earnings from the use of the land are usually proceeds of crop production and are personal property in which the mortgage holder has no interest unless a security interest has been granted and perfected under the Uniform Commercial Code. See United States v. Newcomb, 682 F.2d 758 (8th Cir. 1982); In re Temple Stephens Co., Inc., 156 B.R. 38 (Bankr. W.D. Mo. 1993).

The point of the above discussion is that under current Nebraska law represented by the Uniform Commercial Code, Neb. Rev. Stat. U.C.C. § 9-101, et seq. (1992), a creditor does not have a lien of any sort in crops or the proceeds of the crops

part sub nom Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987). Neither the original opinion by this judge nor the Eighth Circuit opinion attempted to identify the source of funds which were the subject of dispute as either the proceeds of crop production by the debtors or rents from leases entered into by the trustee. However, it is the opinion of this judge that most, if not all, of the funds were rents from leases entered into by the trustee. The only significance of this is that this trial judge is reminded that both attorneys and judges must carefully define the terms being used when attempting to explain the law. Had this judge identified the Mahloch funds as rent, the Eighth Circuit decision would not be any different, but the confusion in the Nebraska Bar, legislature, and courts concerning the possibility of perfecting an interest in crop proceeds by language in a real estate mortgage rather than by compliance with the Uniform Commercial Code probably would not have resulted.

unless it has been granted such lien by the debtor pursuant to the terms of the Uniform Commercial Code.

Under Nebraska law, as discussed in the cases cited above, a mortgage holder or holder of a deed of trust on real estate that has an assignment of rents may treat the rents which are earned after a default in payment of the mortgage note as part of the package of collateral securing the note. The federal cases cited above permit such a creditor to "perfect" a lien on such post-default rents by filing a motion to sequester in the bankruptcy case. When such motion is granted, the rents become cash collateral and subject to the provisions regarding the use of cash collateral as outlined in the Bankruptcy Code.

In this case, there are no rents. The property which FCB desires this Court to sequester is post-petition crops or the proceeds of such crops. Those crops are "goods" as defined by Neb. Rev. Stat. U.C.C. § 9-105(1)(h) (1992) (hereinafter Neb. Rev. Stat. U.C.C. will be designated as U.C.C.). Those "goods" are "farm products." U.C.C. § 9-109(3).

A "security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. U.C.C. § 1-201(37). A security interest in such goods is not enforceable against the debtor and does not attach unless the debtor has signed a security agreement containing a description of the collateral, a description of the land, value has been given and the debtor has rights in the collateral. U.C.C. § 9-203(1). The debtor has no rights in crops until they are planted or become growing crops. U.C.C. 9-203(5)(a).

In this case, the FCB does not have a security agreement which provides for a security interest in personal property such as goods, farm products or crops. Therefore, the motion to sequester does not "perfect" an interest in crops or crop proceeds.

Nebraska Statute § 52-1701 et seq.

In addition to its theory that a motion for sequestration of rents and profits is sufficient to perfect an interest in crops and crop proceeds, the FCB takes the position that the recently enacted Nebraska statute entitled "Security Interest in Rents," Neb. Rev. Stat. § 52-1701, et seq. (Supp. 1993), commonly referred to by its legislative identification "L.B. 14," causes FCB's assignment of rents and profits to be perfected at the time of execution and recording of the documents without the necessity of FCB obtaining the appointment of a receiver, obtaining an order of possession from the state court or obtaining an order

sequestering rents and profits from the bankruptcy court. That statute, adopted by the Nebraska Legislature in 1993, applies to any instrument properly recorded prior to, on, or after February 17, 1993, its effective date. Neb. Rev. Stat. § 52-1708 (Supp. 1993). FCB's instruments containing assignment of rents and profits were properly recorded before February 17, 1993.

The definition of "security interest in rents" in this statute is different from the definition of a "security interest" referred to above in the Uniform Commercial Code. In L.B. 14, a "security interest in rents" means any interest in rents or leases which secures payment or performance of an obligation. Neb. Rev. Stat. § 57-1701(7) (Supp. 1993).

The term "rents" as defined by the statute is any right to income, rents, proceeds, issues, profits, royalties or any other payment or benefit derived under a present or future lease. Neb. Rev. Stat. § 52-1701(6) (Supp. 1993).

The statute, by its own terms at Sections 52-1701(6) and 52-1701(7), applies only to payments or benefits derived under a lease. Minahan, supra, at 173; Steven C. Turner, Nebraska's Adoption of Statutory Provisions for the Creation, Perfection and Enforcement of a Security Interest in Real Estate Rents, 27 **Creighton L. Rev.** 181, 187 n. 19. (1993).

As mentioned above, this case does not involve a lease of real property, and the revenues of this debtor are not the result of a lease of real property. Therefore, L.B. 14 as codified in Neb. Rev. Stat. § 52-1701 through § 52-1708 is not applicable, and the FCB does not have a perfected security interest in the crops or crop proceeds generated post petition.

The motion to sequester is denied.

Separate journal entry to be entered.

DATED: March 10, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Movant, Debtor(s) Atty. and all parties appearing at hearing
[] Chapter 13 Trustee [] Chapter 12 Trustee [] U.S.Trustee

Movant is responsible for giving notice of this journal entry to any parties in interest not listed above.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
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H.J. RUF LAND & CATTLE CO.,)
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DEBTOR(S))
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Plaintiff(s))
vs.)
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Defendant(s))

CASE NO. BK92-81348
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CH. 12
Filing No. 79 & 87

JOURNAL ENTRY

DATE: March 10, 1994
HEARING DATE: January
12, 1994

Before a United States Bankruptcy Judge for the District of
Nebraska regarding Motion by Farm Credit Bank of Omaha for
sequestration of rents and profits and resistance by debtor.

APPEARANCES

James McClymont and James Baumann, Attorneys
Eric Wood, Attorney

IT IS ORDERED:

Motion to sequester is denied. See memorandum this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Movant, Objector/Resistor (if any), Debtor(s) Atty. and all
parties appearing at hearing
[] Chapter 13 Trustee [] Chapter 12 Trustee [] U.S.Trustee

Movant is responsible for giving notice of this journal entry to all other
parties if required by rule or statute.